



Taxation Ruling

Income tax: sale and leasebacks

other Rulings on this topic

IT 28; IT 196; IT 2051;
IT 2287; IT 2354; IT 2395;
IT 2594; TD 93/142;
TD 94/20

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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.*

What this Ruling is about

Class of person/arrangement

1. This Ruling concerns financing arrangements taking the form of a sale and leaseback of assets that were owned by the lessee prior to the sale. Under these arrangements, the owner of an asset sells the asset but continues to use the asset as lessee under a lease from the purchaser.

Legal characterisation of sale and leaseback arrangements

2. To determine the taxation consequences of a transaction it is necessary first to determine the legal characterisation of the transaction. The legal characterisation of a transaction will generally follow its legal form. However, in order to determine the character of a transaction at law it is necessary to look to see what the transaction effects having regard to the legal rights which the transaction confers on the parties thereto. If the legal characterisation of a transaction is that of a sale and leaseback arrangement then consideration of the taxation treatment of the arrangement is based on that characterisation.

Effect of sale and leaseback arrangements

3. Sale and leaseback arrangements have a similar effect to providing finance to the original owner of the asset (in this Ruling referred to as the lessee). Considered from this point of view, the discount rate at which the present value of the lease payments and the residual value equates to the cost of the asset to the lessor provides the notional interest rate implicit in the lease and often this rate is more

attractive to the lessee than prevailing market debt interest rates. This may be possible in part because of tax deductions allowable to the purchaser (referred to in this Ruling as the lessor) as a result of the acquisition of the asset.

4. Sale and leasebacks are recognised in the *Income Tax Assessment Act 1936* (the Act) as transactions capable of having a tax effect: subsection 82AB(7) and Division 16D (note also section 51AD and subsection 57AM(33)).

Ruling

Usual tax treatment of sale and leasebacks

5. Where an arrangement is legally characterised as a sale and leaseback arrangement, the taxation consequences will generally be as outlined immediately below.

6. Where the asset sold is depreciable, and is sold by the lessee for more than its depreciated value, a balancing charge would normally have to be included in the taxpayer's assessable income under section 59 (see Taxation Rulings IT 28, IT 2051 and IT 2354). Where the disposal consideration of depreciated plant is less than its written down value, the difference is an allowable deduction for the lessee.

7. The lessor, as owner of the asset, is entitled to claim a deduction for depreciation, or other deduction, as appropriate. However, subject to the exercise of the Commissioner's discretion under subsection 60(2), the lessor would not be entitled to depreciate the asset for an amount in excess of the sum of the written down value of the asset in the hands of the lessee and any amount included in the assessable income of the lessee: section 60. Where the asset was used for a number of years in the lessee's business operations, it is unlikely that the discretion in subsection 60(2) would be exercised in the lessor's favour (see Taxation Ruling IT 2354).

8. The lease of the asset results in periodic payments by the lessee to the lessor. These are generally deductible to the lessee and the lessor will derive income from the payments on the same basis as for any lease of a similar asset on similar terms where there is no related purchase of the asset from the lessee (see Taxation Rulings IT 28, IT 2051, and Taxation Determination TD 93/142).

9. Normally a lessor would return income from a lease, including a sale and leaseback, by returning the lease income as assessable income and deducting from that income depreciation and any other deductions (the asset method of returning lease income). *FC of T v. Citibank Ltd and Ors* (1993) 26 ATR 423; 93 ATC 4691 (*Citibank* case) has

confirmed that the asset method is the correct method of returning lease income in these circumstances where the lessor is the owner of the leased asset. Payments to the lessor to make up the residual value of the asset to a required level would also have an income character.

Sale value

10. In the circumstances of a sale and leaseback the Commissioner will accept a sale price representing the market value of the asset at the time of sale. The market value will be the price at which an asset can be bought and sold as between a willing, arm's length purchaser and vendor, both acting knowledgeably, prudently and without compulsion. Where there is an identifiable, recognised market for the asset in Australia or overseas, the market value will ordinarily be ascertainable by reference to factual information in that market at the time the sale is made.

11. Where no such market exists, the Commissioner will accept the tax depreciated value of the asset. A sale price significantly above or below that tax depreciated value should be based on independent evidence as to the value of the asset. In the case of a major asset, such evidence could usually be required in the form of an independent valuation by a recognised valuer. The value should reflect the value of the asset separated from the business to which it is leased, because, if the lessor were to exercise rights on default this would be the value for which the asset could be sold by the lessor (cf Alternative view at paragraph 35).

12. If a sale price for the asset at the end of the lease is set at the time the lease is entered into, it may not reflect the actual market value at the end of the lease. Therefore the lease payments may have a capital component. However, the Commissioner will accept an up front valuation of the expected market value of the asset at the end of the lease in the case of long term leases (e.g., greater than four years), provided such valuation is made bona fide, and based on independent evidence or set in accordance with Taxation Ruling IT 28 and Taxation Determination TD 93/142.

Circumstances where sale and leasebacks may have a different tax effect

13. There may be circumstances where arrangements entered into as sale and leaseback transactions have tax consequences different from those outlined above.

Sham Transactions

14. In sale and leaseback arrangements the likely legal characterisation of those transactions will be as a sale of the asset from the lessee to the lessor, and a leaseback of the asset. This is no less likely where the parties have factored in the tax effects that flow from that characterisation as a necessary ingredient of the deal. However, there may be cases where the intention of the parties is that the documents are not to create the legal rights and obligations which they give the appearance of creating, i.e., the documents are a sham or facade; see *Snook v. London and West Riding Investments* (1967) 2 QB 786 at 802. Where the transaction is a sham or facade it remains necessary to determine the tax consequences of the transaction.

15. In each case the totality of the facts need to be considered to determine the intention of the parties. However, it is not appropriate, for example, to treat the payment by the lessor as a loan, and the lease payments and the payment of the residual as payments of interest and principal, where the arrangement is a legally valid sale and leaseback arrangement.

Where the asset is a fixture

16. Generally speaking, and subject to statutory provisions to the contrary, when an item is a fixture on land it is part of the land and owned by the owner of the land and cannot be sold separately from it. Where this is the case a fixture is not an asset which the lessor could make the subject of a lease.

17. Whatever the merits of the argument that something less than legal ownership is sufficient for depreciation purposes (see Alternative view at paragraph 45), it is stretching the form of a sale and leaseback arrangement too far to say:

- that the lessor acquires 'ownership' for the purposes of section 54 of the Act during the term of the transaction; and
- that the original owner (i.e., the person who has purchased an asset which has become a fixture) does not have an implied guarantee that it would reacquire the right to use the asset at the end of the lease, in circumstances where:
 - the asset in question is a fixture;
 - that person sells a mere right to use that asset to a financier;
 - who then leases back that right to use to that person; and

- who retains possession and use of the asset at all times.

Where the lease payments may be partly of a capital nature

18. The lease payments are likely to be partly of a capital nature when sale and leaseback arrangements include an option or other right for the lessee to acquire the asset. In cases where the presence of the option or right is considered as bringing about the result that part of the lease payments are of a capital nature, the leaseback will be treated by the ATO as akin to hire purchase arrangements, giving the lessee the ownership of the asset for depreciation purposes: refer to Taxation Rulings IT 28 and IT 196.

19. This may also occur where the lease payments support the lessee's acquisition of the asset for a consideration less than the market value, or the lease is for the whole of the useful life of the asset.

Where the lessor is deemed by subsection 51AD(10) not to have used the asset, or held the asset for use, for purposes qualifying under section 51AD.

20. Section 51AD may apply to a sale and leaseback of an asset the acquisition of which by the lessor was predominantly funded by non-recourse debt and either the asset was used or held for use by the lessee at a time earlier than six months before acquisition by the lessor, or the asset was first used or held for use by the lessee within that six months but was not in existence at the time of the arrangement for sale and leaseback.

Part IVA

21. Part IVA will not have a general application to sale and leaseback arrangements: refer to paragraphs 50 to 60 below. However, the ramifications of Part IVA on a particular set of facts will always be judged on a case by case basis: see *Case W58* 89 ATC 524 at 536; *AAT Case 5219* (1989) 20 ATR 3777 at 3793.

22. Generally speaking, it would be expected that the terms of the arrangement would, subject to subsection 51AD(6), be consistent with an ordinary business or commercial dealing.

23. In most situations, sale and leasebacks will be explicable on a commercial basis, for both lessees and lessors. However, closer attention will be given to the application of Part IVA where:

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- (a) an appropriate balancing charge and/or capital gain is not included in the assessable income of the lessee and lessor as applicable;
- (b) at the time the sale and leaseback is entered into there is an intention to assign the right to income arising from ownership of the asset during the period of the lease;
- (c) appropriate values are not used (both in relation to the sale of the asset (see paragraphs 10 to 12 above), and for the purpose of setting the residual value for the asset (see Taxation Ruling IT 28));
- (d) the overall sale and leaseback arrangement itself was not designed to provide a positive cash result to the lessor before taking into account the tax benefits, subject to the effect of investment and/or development allowance (see Taxation Rulings IT 2220 and IT 2051); or
- (e) the tax elements of the scheme, having regard to the facts of the case, outweigh the commercial elements.

24. For the purpose of considering the application of Part IVA to any given arrangement, it is not expected that taxpayers will need to maintain any special information for tax purposes other than the ordinary commercial details which they would have about the transactions, and details of the relevant values of the asset (as per paragraphs 10 to 12 above).

25. Where a tax benefit as defined in subsection 177C(1) is identified in connection with a scheme, it is then necessary to determine objectively whether it would be concluded that the sole or dominant purpose of the scheme was the obtaining of the tax benefit. The fact that one or more of the parties have factored in the tax effects which they expected to flow from the sale and leaseback transaction as a necessary ingredient of the deal does not of itself lead to a conclusion that the obtaining of such tax effects was the sole or dominant purpose. Similarly a tax benefit to lessees is unlikely to be the dominant purpose of a party to a sale and leaseback where neither the price at which an asset is sold nor the residual value of the asset are determined other than by reference to the appropriate values of the asset.

26. However, there may be cases where the weighing up of all the facts (including any or all of the factors listed at paragraph 23) could lead to a conclusion that the dominant purpose is to obtain a tax benefit. For example, a relevant factor may be where depreciation deductions or other deductions related to ownership represent substantially the benefits obtained by a lessor. Similarly, a dominant purpose of obtaining a tax benefit might exist where inflated lease

payments are made under a scheme, or where an appropriate balancing charge which reflects the sale value of the asset (less its tax written down value) is not included in assessable income (see paragraph 6 above).

27. In those cases where Part IVA applies, the Commissioner would have to determine which taxpayer could reasonably be expected, but for the scheme, to have derived assessable income, or not to have then been entitled to a particular tax deduction. How the Commissioner would do this would depend on the facts of each case.

Date of effect

28. 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).

Explanations

Usual tax treatment of sale and leasebacks

29. In summary, the usual tax effect of sale and leaseback arrangements will be as follows:

- (a) the lessor is entitled to claim a deduction for depreciation, or other deductions, as appropriate; and
- (b) the lessee is entitled to claim the lease payments as a deduction in full.

30. Before 1 July 1990, the ATO accepted that lessors could return lease income under the finance method, in place of the asset method, subject to other conditions and assumptions set out in Taxation Rulings IT 2162 and IT 2166. The ATO withdrew its recognition of this method of returning lease income with effect from 1 July 1990 by Taxation Ruling IT 2594. An addendum to that Ruling enabled lessors to continue to use the finance method until 1 August 1990 in some circumstances. The extension did not apply to sale and leaseback transactions in respect of used property.

Sale value

31. In the circumstances of a sale and leaseback the Commissioner will accept a sale price representing the market value of the asset at the

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time of sale. The market value will be the price at which an asset can be bought and sold as between a willing, arm's length purchaser and vendor, both acting knowledgeably, prudently and without compulsion. The Commissioner's view is that generally speaking the lessor's rights in respect of a leased asset would apply in circumstances where that asset would be separated from the business of the lessee, and that a market value would reflect this fact.

32. Where there is an identifiable, recognised market for the asset, the market value will ordinarily be the market selling value in that market at the appropriate time. It is expected that some independent evidence of market prices should be obtained and be available if required. The type of evidence will naturally vary with the nature of the asset; however it would usually include details of market selling prices for similar assets at the relevant time.

33. Where no ready market exists, the Commissioner will accept the tax depreciated value of the asset. A sale price significantly above or below that tax depreciated value should be based on independent evidence as to the market value of the asset, and reflect the extent of the lessor's rights as discussed above. In the case of a major asset, such evidence would usually consist of an independent valuation by a recognised valuer, showing the full basis for the valuation. In some cases, where unique or complicated circumstances make valuation contentious, two or more valuations should be obtained in respect of more valuable assets. For such valuations, evidence of the reasoning underlying the acceptance of one valuation in preference to another different valuation, should also be available if required.

34. If a market price for the asset at the end of the lease is set at the time the lease is entered into, it may not reflect the actual market value at the end of the lease. Therefore the lease payments may have a capital component to the extent that the market price is less than the eventual market value at the time of sale. The Commissioner, however, will accept an up front valuation of the expected market value of the asset at the end of the lease in the case of long term leases (e.g., greater than four years), provided such valuation is made bona fide and based on independent evidence.

Alternative view on sale value

35. An alternative view which has been advanced is that there should be no requirement for the asset to be valued separate from the business. It has been suggested that there is no basis for the Commissioner to prescribe how an asset should be valued, particularly if an independent valuer is performing the function. It is further said that there are a variety of valuation methodologies, and that it is not

uncommon for the value of an asset to be determined based upon the present value of the future income expected to be generated by the asset. The Commissioner recognises that there are a number of possible valuation methodologies, but in the interests of providing greater certainty to the business community has indicated that which is considered to be most appropriate to those arrangements properly characterised as sale and leaseback. The reasoning why a value separated from the business is considered to be the most appropriate is outlined above.

Where the transactions have a different tax effect

Sham

36. The form of an arrangement, including the description of the transactions by the contracting parties, often provides the strongest indicator of the proper legal characterisation of the arrangement. However, there are occasions where the ostensible form of an arrangement may be disregarded. These occasions will occur where the parties use the purported arrangement as a disguise, a facade, a sham, or a false front, to conceal their real transaction - i.e., the transaction is a 'sham transaction' (see *Scott v. Commissioner of Taxation (No 2)* (1966) 14 ATD 333; 40 ALJR 265; *Sharrment Pty Ltd and Ors v. Official Trustee in Bankruptcy* (1988) 82 ALR 530; *Ascot Investments Pty Ltd v. Harper and Harper* (1981) 148 CLR 377; *Gould and Gould; Swire Investments Ltd* (1993) FLC 92-434; and *Snook v. London and West Riding Investments* (1967) 2 QB 786 at 802).

37. However, the inference that a transaction is a sham will require strong support from the circumstances of the arrangement, and cannot be inferred lightly. This is because some of the factors which can contribute to the conclusion that an arrangement, though in the form of a sale and leaseback, is not, despite its apparent form, intended by the parties to take effect as a sale and leaseback will not by themselves usually lead to that conclusion.

Legal characterisation of the arrangement

38. In *ANZ Savings Bank Ltd v. FC of T* (1993) 25 ATR 369; 93 ATC 4370, Hill J noted as follows (ATC at 4389; ATR at 391-392):

'What must be determined in the present case is whether the transaction into which the parties have entered is a loan involving the repayment of a principal sum with interest, or whether it is a contract for an annuity, or a contract for insurance. In the absence of a submission that the transaction

entered into by the parties is a sham, a disguise for some other and different transaction, and in the absence of the application of the anti-avoidance principles of Part IVA of the Act, **the court must look to see what the transaction entered into by the parties by its terms effects**. That is to say, **regard must be had to the legal rights which the transaction actually entered into confers**. Invocation of the doctrine of substance is of no assistance in this task' (emphasis added).

39. Factors which would indicate, in some circumstances, that the legal characterisation of a transaction was not that of sale and leaseback would include:

- (a) the intention of the parties as determined from the documentation and surrounding circumstances;
- (b) the lessor has no right to obtain possession of the asset on default by the lessee;
- (c) all the risks and benefits of ownership of the asset are with the lessee after the termination of the term of the lease (this could occur where the lessee was entitled to any excess of the sale price of the asset over the residual value);
- (d) the lease is for a period that is likely to exhaust the remaining useful life of the asset (see *FC of T v. Ballarat & Western Victoria TV Ltd* 78 ATC 4630; (1978) 9 ATR 274);
- (e) the lessee has a right or option to purchase the asset upon expiration of the term of the lease for less than the market value of the asset; or
- (f) the sale price of the asset to the lessor is substantially in excess of the market value of the asset.

40. However, this is not a checklist, and it is clear that a sale and leaseback transaction cannot, without more, be characterised as a loan transaction merely because the result of the transaction is an in substance loan - see Hill J in *ANZ Savings Bank Ltd v. FC of T* cited above.

41. That this is so is to be gathered from such provisions as section 51AD, which would not need to apply specifically to sale and leaseback if those transactions always took effect at law as a loan, or as a sale and repurchase. Similarly, the existence of one or other of the above features will not necessarily provide a sufficient basis for characterising an arrangement at law as a loan rather than a sale and leaseback, or else there would be no need for Division 16D of Part III

of the Act. In this regard see also Hill J in *Citibank* (ATR at 435-436; ATC at 4702).

Fixtures

42. In general, and subject to any statutory provisions to the contrary, when an item is a fixture on land it is part of the land and owned by the owner of the land and cannot be sold separately from it. For example, see *Mills v. Stokman* (1967) 116 CLR 61. Where an asset, the subject of a purported sale and leaseback, is a fixture on land of the lessee, there can be no transfer of the legal title of the asset to the lessor separate from the land: see, for example, *Case W18 89* ATC 223; *AAT Case 4883* (1989) 20 ATR 3278.

43. While facts may differ in individual cases, the ATO view relating to fixtures **in the context of sale and leaseback arrangements** is based on the following scenario:

- the lessee originally purchased the asset;
- the lessee retains possession of the asset and continues to use it in its business;
- the asset is affixed to the land, in respect of which the lessor has no interest, and is a fixture;
- the documents seek to reflect a sale of a legal interest in the asset or of rights in the asset to the lessor, and lease of the asset or relevant rights back to the lessee; and
- the lessee regains all rights to the asset at the end of the lease.

44. In the circumstances outlined above, even if the sale and leaseback documents were to make reference to something less than legal ownership of the asset (e.g., a right to use), it is not considered that they provide the lessor ownership of the asset for the purposes of section 54. It is also considered that Part IVA might apply to these arrangements because of their contrived nature.

Alternative view on fixtures

45. An alternative view advanced is that a purported sale and leaseback involving fixtures, even though not in effect a passing of the property at law, grants to the purchaser a right to sever and remove the fixture (at which time legal ownership would pass). It is further said that the purchaser obtains a contractual right, an equitable title to the fixture, and an ancillary equitable interest in the land, and that these rights would amount to sufficient ownership by the purchaser for the

purposes of claiming depreciation under section 54. The Commissioner recognises that such arrangements create contractual rights (and possibly equitable rights). However, in the context of a sale and leaseback, where neither possession nor legal interests in the asset pass to the lessor, the Commissioner does not accept that the rights which a lessor may have constitute ownership for the purposes of section 54. Where a lessor actually takes possession of the asset, and thereby assumes legal ownership, depreciation deductions may then be available.

Capital component of lease payments

46. Arrangements for the repurchase of the asset, whether they are automatic or occur at the option of the lessee, are likely to be regarded as akin to a hire purchase agreement. In circumstances where the arrangement for repurchase of the asset was regarded as akin to a hire purchase arrangement, the lessee would be allowed a deduction for the revenue component of the payments, and consistent with current ATO practice, for depreciation (see Taxation Rulings IT 28 and IT 196, but cf (1955) 5 CTBR (NS) *Case 90*).

47. Where a lease or an associated arrangement provides for acquisition of the asset from the lessor by the lessee at an undervalue then the lease might to that extent have a capital character. Deductions for lease payments by the lessee will not be allowed to the extent of that capital component.

Section 51AD

48. Property is not taken to have been owned and used or held for use by the end-user or an associate if the property was first used or held for use by that person at a time within 6 months before the acquisition of the property by the owner and at that time there was in existence an arrangement that the property would be sold to another person and then leased by the end-user or an associate: subsections 51AD(5) and (6). But see also the requirements of Taxation Ruling IT 2051 concerning leveraged lease arrangements.

49. Broadly, a non-recourse debt is one where the lender's rights against the borrower in the case of default in repayment are effectively limited to rights against the property, or against income generated or goods produced by the property. Generally, this test is satisfied either by a contractual limitation of the rights of the creditor against the assets of the borrower or by the fact that the borrower has insufficient assets, other than those specifically listed in paragraph 51AD(8)(a), to satisfy the claims of the creditors in the event of a default.

Part IVA

50. In limited situations, the general anti-avoidance provisions of Part IVA of the Act might apply even where the relevant documentation properly reflects the characterisation of the transactions as a sale and a leaseback.

Scheme

51. A scheme, for the purposes of Part IVA, is widely defined in section 177A. A part of a scheme may itself be a scheme. However, a part of a scheme will not be a scheme if that part is incapable of standing on its own without being robbed of all practical meaning: see *FC of T v. Peabody* (1994) 28 ATR 344 at 352; 94 ATC 4663 at 4670 (*Peabody* case).

52. Subject to the facts of the case, a scheme could include a sale itself and a leaseback itself or both transactions together, although the latter would be the more common scenario.

53. It could also include arrangements in the context of a sale and leaseback involving steps to avoid the inclusion in the assessable income of a relevant taxpayer of amounts that would otherwise be assessable to the taxpayer under section 59, or steps to assign that income to another entity. It could also include arrangements in the context of a sale and leaseback which seek to produce an artificial sale price for the asset or an artificial guaranteed residual value under a lease. It could also include arrangements designed to provide deductions for inflated lease payments.

Tax benefit

54. A tax benefit exists for the purposes of Part IVA where it might reasonably be expected that an amount would be included in assessable income or a deduction would not be allowable, to the taxpayer in a year of income, if the scheme had not been entered into or carried out: section 177C. Determining whether this is the case depends on the facts and involves 'a prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out and the prediction must be sufficiently reliable for it to be regarded as reasonable': *Peabody* case ATC at 4671; ATR at 353.

55. It would be usual in sale and leasebacks for a relevant tax benefit to arise because of the availability of depreciation or other amortising deductions in respect of the asset, being deductions which might

reasonably be expected not to have been allowable to the lessor if the scheme had not been entered into or carried out. While this matter is dependent on the facts of each case, one scenario could be that the asset, which at all times remains in the possession of the lessee, would continue to be owned by the lessee but for the scheme. The depreciation deductions would have been available to the lessee, not the lessor, in these circumstances. In a case where the lessee needed funds to finance its operations, a reasonable expectation on the facts of that case could be that the lessee would have secured the funds in the form of a loan or some other financing arrangement, and that the assets would not have been sold under these arrangements. Financing options canvassed by the taxpayer before deciding to enter a sale and leaseback would be relevant to this issue. An alternative prediction, depending on the facts, could be that financing arrangements would not have been entered into but for the tax benefits available under the arrangements. In each case, the depreciation deduction would not have been available to the lessor but for the scheme.

56. In sale and leasebacks a relevant tax benefit could also be the deduction for the lease payments where, but for the scheme, the taxpayer would have been entitled to lower deductions, or no deductions at all, or deductions otherwise than for lease payments. Although there may be no reduction overall in the assessable income of the taxpayer, or an overall increase in the amount of deductions allowable, a tax benefit for the purposes of Part IVA may arise.

57. But for Part IVA to operate, the identification of a tax benefit alone is not enough without a dominant purpose.

Dominant purpose

58. Taxpayers should note that Part IVA may apply even where the obtaining of a tax benefit is the dominant purpose of only one party to a scheme. For this reason, lessors and lessees should consider the possibility of such a purpose on the part of a counterparty. However, dominant purpose must relate to the whole of the scheme (which could be part of the total arrangement), even where the relevant purpose is that of a person who carries out only part of the scheme: *Peabody* case ATC at 4670; ATR at 352.

59. In order to determine whether a person entered into or carried out a scheme for the purpose of obtaining a tax benefit regard needs to be given to each and every one of the objective factors outlined in paragraph 177D(b): refer to *Spotless Services Ltd and Anor v. FC of T* (1993) 25 ATR 344 at 367; 93 ATC 4397 at 4415 and *FC of T v. Peabody* (1993) 25 ATR 32 at 41; 93 ATC 4104 at 4113. In

evaluating the criteria in paragraph 177D(b) particular relevance needs to be given to the following factors:

- (a) **The manner in which the scheme is entered into or carried out.** A matter relevant here for sale and leasebacks would be whether the value ascribed to the asset is so high or so low that it cannot be justified as reasonably related to the fair market value of the asset. The failure to attempt to arrive at a fair market value for an asset, or the sale of an asset at an inflated or artificial value, or the inclusion in the lease agreement of an unreal or nominal residual value, could highlight the artificiality of the arrangements. These features might also suggest that the underlying rationale for the particular scheme was to obtain a tax benefit. Similar indications exist where an uncommercially low residual value is ascribed to the asset at the end of the lease.

Other relevant features include the manner in which the scheme was marketed (e.g., where the availability of tax benefits are emphasised).

- (b) **The form and substance of the scheme.** The factors which show the financing character of sale and leasebacks are in substance loans are also relevant in determining the objective purpose of arrangements taking that form. However, the scheme may assume such a commercial character as to exclude the operation of Part IVA. In this regard note the comments of O'Loughlin J in *Peabody v. FC of T* (1992) 24 ATR 58; 92 ATC 4585 at first instance (ATR at 68; ATC at 4594).

As was referred to in paragraph 44 above, the contrived nature of a sale and leaseback of a fixture that continues to be used by the lessee would also be a relevant factor.

- (c) **The time at which the scheme was entered into and the length of the period during which the scheme was carried out.** This factor is relevant to cases where the arrangements are entered into at a time when the lessee has losses to absorb any balancing charge (particularly where these losses would not be available in subsequent years, e.g. the lessee might be seeking to refresh stale or non-transferable losses) and the lessor is in a position to utilise deductions available as a consequence of its ownership of the asset.

The particular timing of the arrangement (e.g. year end) and the duration of the scheme (e.g., limited to the period

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during which the lessor obtains a tax benefits around which the scheme is structured) and the nature of the tax benefit (e.g., where there are accelerated depreciation benefits) are also relevant to the question of dominant purpose.

- (d) **The result in relation to the operation of the Act that would but for Part IVA be achieved by the scheme.** Sale and leaseback arrangements allow the lessor to claim deductions flowing from the ownership of the assets, even though the asset may have been previously owned by and used by the lessee, continues to be used by the lessee, and is often repurchased by the lessee or an associate of the lessee on the expiration of the lease. These deductions would not otherwise be available to the lessor if finance had been provided to the lessee in some other form, for instance a loan.
- (e) **Any change in the financial position of the relevant taxpayer that has resulted from the scheme.** The extent of the commercial profit from the transactions relative to the tax benefits obtained under the arrangements is relevant in determining dominant purpose. However, any income actually included in the assessable income of the lessor on the resale of the asset after the lease is terminated would need to be taken into account in this regard. For example, the later inclusion in the return of the lessor of assessable income based on a realistic residual value will increase the likelihood that the commercial purpose of the arrangement predominates over the purpose of acquiring tax benefits. Of course the question of dominant purpose will depend ultimately on the facts of the particular case, including the amount of the balancing charge, the commercial returns from the transaction(s) in total and relative to profits that could have been derived if the funds had been provided to the lessee in some other way, and the size of the tax benefit.

On the other hand, where steps are taken to avoid the operation of the balancing charge provisions in section 59, there is a likelihood that the totality of the arrangements, or these extra steps, could be stamped as a scheme entered into with the dominant purpose of avoiding tax.

The same can be said of arrangements to assign assessable income after the lessor has taken advantage of the tax benefits, particularly where the recipient of the assessable

income is exempt from tax or has substantial losses which can absorb the income.

(f) **The nature of any connection between the parties.**

This would be relevant, for example, where arrangements are entered into which contain features which are not usually found in sale and leaseback arrangements or where there has been an inflation of the lease payments for the purpose of obtaining excessive deductions.

60. The factors listed above should not be viewed in isolation of the whole range of circumstances surrounding the arrangements, and do not of themselves provide a checklist for the application of Part IVA.

Conclusion

61. As is the case in determining the legal characterisation of the arrangements, or the circumstances in which sale and leaseback arrangements might have a different tax effect, the application of Part IVA is dependant on the facts of each case. However, as a rule of thumb, most sale and leasebacks will have their usual tax effect, and Part IVA will not apply, where appropriate values are used (in respect of the sale price of the asset, the lease payments, the residual value of the asset and the balancing charge), where there is no question as to the arrangements having a different tax effect (cf fixtures, arrangements akin to hire purchase or where there may be a capital component), and where there is no dominant purpose of obtaining a tax benefit.

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