TR 2009/5EC - Compendium

Ruling Compendium – TR 2009/5

This is a compendium of responses to the issues raised by external parties to draft TR 2009/D2 – Income tax: trading stock – treatment of discounts, rebates and other trade incentives offered by sellers to buyers

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Entity/ies commenting	Issue raised	Tax Office Response/Action taken
1	Entity 1	An incentive agreed up front as part of a purchase transaction is directly related to the purchase.	Incentives may be agreed at or before the point of purchase. However, the reasons for which a trade incentive is paid determine the income tax treatment of the payment. Incentives may be paid directly to reduce the cost of trading stock or may be paid for another purpose such as reimbursing the buyer for carrying out promotional activities or securing a commercial benefit for the seller in relation to its brand or future sales of its products. The purpose of the payment, and not when it is paid or agreed, is the relevant criterion. Assuming that the trade incentive does relate directly to the purchase of trading stock, the relevant test as per paragraph 5 of the draft Ruling and the final Ruling is whether the incentive 'is subject to a condition that has not been satisfied at the time of the purchase'.
2	Entity 1	Unless agreed otherwise or unless an alternative purpose is evident, an incentive can only act to reduce the cost of buyer's trading stock.	See comments on Issue 1. The reasons for and the circumstances relating to a trade incentive will depend on the terms of the agreement/contract between the buyer and the seller and will determine its income tax treatment.

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3	Entity 1 Entity 2	The meaning of cost should be its ordinary or commercial meaning. The ordinary or commercial meaning of the cost of an item of trading stock is the net outlay after discounts and rebates.	The relevant statutory test for characterising expenditure for the purposes of section 8-1[1] is whether it represents a 'loss or outgoing … incurred in gaining or producing … assessable income … or … is necessarily incurred in carrying on a business for the purpose of gaining or producing … assessable income.' The section 8-1 position of the buyer is fully dealt with in paragraphs 49 to 58 in Taxation Ruling TR 96/20 under the heading 'Customer's allowable deductions.' Paragraphs 72 to 74 of the draft Ruling and paragraphs 78, 87 and 88 of the final Ruling state that the position expressed in TR 96/20 in relation to section 8-1 remains the Tax Office view. See also paragraph 88 of the draft Ruling. The Tax Office view is that a taxpayer's 'cost' of trading stock for the purposes of subsection 70-45(1) includes all relevant costs that are allowable deductions in calculating the taxpayer's taxable income – see paragraph 21 of Taxation Ruling TR 2006/8 in this regard.
4	Entity 1 Entity 3	The compliance costs may be substantial. The tax treatment proposed by TR 2009/D2 will add to taxpayers' costs of compliance and to the Tax Office burden in auditing compliance. The Tax Office should prescribe a method of treatment for settlement discounts and rebates that taxpayers will be able to comply with more easily.	The Tax Office must apply the law as it interprets it and cannot support a 'compliance cost' outcome that is contrary to the law. Taxpayers with concerns in relation to compliance costs are invited to contact the Tax Office to discuss.
5	Entity 4 Entity 5 Entity 3	The income tax treatment should be consistent with the treatment required for Goods and Services Tax (GST) and Wine Equalisation Tax (WET).	The specific rules in the GST legislation provide that an 'adjustment event' has the effect of reducing the consideration for a supply or an acquisition. There is nothing comparable in the income tax legislation having the effect of reducing the amount of expenditure that has been 'incurred' such that an amount previously incurred

[1] All subsequent legislative references are to the ITAA 1997 unless otherwise stated.

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			would no longer be incurred. Depending on the circumstances, the income tax treatment of a reduction in an amount previously incurred is typically that the reduction is income under ordinary concepts or statutory income by way of an assessable recoupment. More generally, the rules for determining the taxable value for transactional taxes such as GST and WET, and the way in which they may operate retrospectively to adjust what would otherwise be the taxable value, are not necessarily relevant to the determination of assessable income and allowable deductions which relate to an income year and not to a specific transaction.
6	Entity 4	Just because an incentive is subject to a condition does not mean that the incentive is not directly related to the cost of trading stock.	See Issue 1. The Tax Office view is that, where the consideration in relation to an event that has occurred may be adjusted subject to the happening of a future event, it is typically the happening of the future event that the adjustment relates to.
7	Entity 5	The alternative view put forward in paragraphs 103 to 108 should be adopted in the Ruling.	The 'alternative' view as set out in paragraphs 103 to 108 of the draft Ruling and paragraphs 109 to 114 of the final Ruling was thought to be the correct view when Draft Taxation Ruling TR 94/D4 was issued on 20 January 1994. The 'alternative view' was rejected in TR 96/20 which issued on 5 June 1996. The position taken in TR 96/20 is considered to be correct and no subsequent judicial decisions support any contrary view. See the Tax Office response to Issue 26.
8	Entity 5 Entity 3 Entity 2	The accounting treatment of trade incentives should be followed for income tax purposes.	Paragraph 109 of the draft Ruling and paragraph 115 of the final Ruling say that accounting standards are not considered relevant. TR 96/20 deals with the timing of assessable income and allowable deductions for the purposes of subsections 25(1) and 51(1) of the *Income Tax Assessment Act 1936* (now sections 6-5 and 8-1 of the ITAA 1997 respectively). AASB 102.11 – effective as of 1 July 2007 – does not provide a basis for altering the taxation view on this issue.

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			Accounting standards may be of assistance where neither legislation nor judicial authority provides guidance. However, where trade incentives are directed towards a particular end, the taxation legislation and judicial authorities must prevail. For example, 'incurred' does not have a variable meaning that moves in tandem with changes in accounting standards. Judicial authority in this area has been of assistance principally in relation to the income treatment and of limited, if any, assistance in relation to the deduction side of the transaction.
9	Entity 5	The draft Ruling is effectively a non-legislative change to the law.	The draft Ruling does not represent any change in any current (or former) Tax Office view.
10	Entity 5	There appears to be no clearly expressed rationale for this dramatic change in the Tax Office's well established view.	See Issue 9. There has been no change in any Tax Office's 'well established' view. This Ruling is consistent with TR 96/20.
11	Entity 5	The categorisation and timing recognised by the seller should also apply to the buyer. The treatment for the buyer in Example 4 in relation to a prompt payment discount should mirror that of the seller.	Long standing judicial authority establishes that an amount derived by a seller of trading stock for the purposes of section 6-5 is not necessarily the amount incurred by the buyer for the purposes of section 8-1.
12	Entity 5	In practice any apportionment will be arbitrary.	Apportionment should be based on the facts. Reasonable estimates would obviously be acceptable to the Tax Office.
13	Entity 5	Paragraph 26 of the draft Ruling should be expressed in clearer terms. 'We presume that 'all subsequent items' refers to acquisitions after the 100,000 target is reached. We suggest that this is made clear for the reader.'	Paragraph 24 of the draft Ruling and paragraph 25 of the final Ruling refer to 'the first 80,000 items' Paragraph 25 of the draft Ruling and paragraph 26 of the final Ruling refer to 'the next 20,000 items'. Paragraph 26 of the draft Ruling refers to 'all subsequent items'. Paragraph 27 of the final Ruling clarifies the position by referring to 'all items purchased/sold after the 100,000 items threshold is

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			achieved'.
14	Entity 5	The principle outlined in Example 4 with respect to the issue of certainty is not being applied consistently.	The *Ballarat Brewing* case and the *Ballarat Brewing* principle deal with income derived by a seller of trading stock. The 'virtual certainty' principle that follows from that case can only be applied to the seller of trading stock dealing with its buyers in a similar situation as applied in the *Ballarat Brewing* case. There is no judicial authority in either *Ballarat Brewing* or other decided cases to support the view that the 'virtual certainty' principle applies to the determination of the amount incurred by a buyer in purchasing trading stock.
15	Entity 5	The ATO should provide a practical application of the virtual certainty principle.	The Tax Office disagrees. The meaning of 'virtual certainty' is clear. Refer to Example 4 in paragraphs 31 to 34 of the draft Ruling and Examples 4 and 5 in paragraphs 32 to 39 of the final Ruling.
16	Entity 5	How should the offering of new incentives by suppliers be treated?	Paragraphs 4 to 11 of the draft Ruling and paragraphs 4 to 12 of the final Ruling deal with general principles. All incentives are covered by those general principles. The Ruling then illustrates typical scenarios through the inclusion of comprehensive and representative practical examples.
17	Entity 5	Where a new arrangement replaces a pre-existing arrangement, will the Tax Office allow the history in respect of the previous arrangement to determine certainty in respect of the new arrangement.	See Issue 16. The Tax Office accepts that the history in relation to a previous arrangement may be relevant to a replacement arrangement. Nevertheless, the taxation consequences for each arrangement depend on the particular facts. More generally, a number of factors may be relevant in determining whether something may be treated as practically certain. It is essentially a matter for judgment.
18	Entity 5	Taxpayers with a relatively low annual turnover should be allowed to treat trade incentives as a reduction in the cost of or the sale price of trading stock.	Information regarding administrative concessions will be dealt with separately from the public ruling. The Tax Office agrees that certain administrative thresholds such as a $10 million concession should be considered. Any decision reached will be appropriately

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			publicised.
19	Entity 5	The Tax Office has chosen to prescribe a treatment that it considers more favourable to the revenue.	The Tax Office disagrees. The draft Ruling is not driven by any revenue enhancement and does not represent any change in any Tax Office view.
20	Entity 5	The predominant purpose of a bundled rebate is a volume rebate. The Ruling should provide a general rule that where apportionment is not possible, bundled rebate arrangements should be treated entirely as volume rebates.	A bundled rebate is a composite rebate and is not in essence a volume rebate. The Tax Office does not agree that a composite rebate with an indefinite character should be re-categorised as a particular rebate with a particular character. Examples 8 and 9 of the draft Ruling and examples 9 and 10 of the final Ruling illustrate the income tax treatment of bundled rebates.
21	Entity 5	A discount paid by a seller to a buyer to cover the cost of transport incurred by the buyer to transport stock from its warehouse to its retail outlets should be treated by the buyer as a reduction in the cost of trading stock for income tax purposes. The rebate reflects the reduced cost to the seller in delivering trading stock to the buyer's warehouse rather than to a number of the buyer's retail outlets.	The Tax Office agrees. The discount 'relates directly to the [buyer's] purchase of trading stock', is not 'subject to a condition that has not been satisfied at the time of sale', and is sufficiently connected to the buyer's acquisition of trading stock.
22	Entity 2	Most arrangements reflect an 'intention and conduct' of the parties clearly directed to reduce the purchase price of the stock.	The Tax Office view is that the income tax treatment of particular trade incentives is determined by the contractual arrangements between the parties.
23	Entity 2	The ATO has ignored Taxation Ruling TR 96/6.	The Tax Office does not accept that there is any substantive parallel between '***purchasers*** who receive benefits from aircraft manufacturers in consideration for entering into agreements to purchase or order new ***aircraft***' and buyers who purchase trading stock for resale in the circumstances dealt with in the draft Ruling. The circumstances dealt with in TR 96/6 are substantially different and not relevant to the circumstances under consideration.

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24	Entity 2	The ATO should not be selective in when it wants to use commercial principles and accounting conventions to support a view on the meaning of 'cost'.	The relevant meaning is the meaning of 'incurred' in section 8-1. Refer response to Issue 8.
25	Entity 2	TR 2009/D2 should acknowledge the conclusion of the Australian Accounting Standards Board who concluded that in the case of volume based promotional rebate there was a direct nexus between the rebate and the acquisition of the stock and there was a sufficient connection between the payment of the rebate and any promotional activity provided by the retailer.	The meaning of 'incurred' for the purposes of section 8-1 is not affected by the views of the Australian Accounting Standards Board about how rebates should be treated for the purposes of accounting reports. For taxation purposes the key question to be considered is whether the rebate is a payment for services or a payment to reduce the cost of the trading stock.
26	Entity 3	It is difficult to arrive at a conclusion that a buyer has subjected itself to the gross amount of the cost of trading stock where the buyer does not intend to pay the full amount.	The Ruling is consistent with paragraph 57 of TR 96/20 which states that: > Although the opportunity for the customer to avail itself of the discount is provided in the contract of sale and, therefore, exists at the time of sale, the right to the discount itself does not. The right to the discount is only triggered by the payment of the discounted price within the discount period. At the time of sale, the right to a discount is a contingency only which may be satisfied at a later time by the occurrence of a specified event. The effect of the occurrence of that later event cannot operate to alter retrospectively the position which existed at the time of sale. The availability of a discount provides no more than an opportunity for the customer to acquire the goods at an actual cost less than their contracted price. In these circumstances, the incurrence of the liability under the contract of sale and the later satisfaction of that liability are two separate, albeit related events. The Ruling is consistent with TR 96/20 and does not suggest any change in the Tax Office view expressed in TR 96/20.
27	Entity 3	A 'truth and reality' test should be applied rather than a 'virtual certainty' test.	The Tax Office understanding of the *Ballarat Brewing* case is set out in Taxation Ruling TR 96/20. The Ruling is not intended to change what was said in TR 96/20 – see comments on Issue 26 – but is intended to deal with a broader range of trading circumstances than were dealt with in TR 96/20.

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28	Entity 3	The term 'seller' should mean an entity that sells trading stock to a buyer irrespective of whether the buyer is acquiring the trading stock from the seller for the purposes of resale for its own use.	The Ruling is dealing with factual situations where the buyer purchases trading stock and calculates the cost of trading stock on hand at year end. There is no apparent reason to expand the scope of the Ruling to cover the situation where the buyer purchases items for its own use.
29	Entity 2	As both TR 2006/8 and TR 2009/D2 discuss the meaning of 'cost' it is difficult to reconcile why accounting principles and conventions should be relevant in TR 2006/8 but not relevant in TR 2009/D2.	There is no inconsistency between TR 2006/8 and TR 2009/D2. Paragraph 6 of TR 2006/8 states that 'cost of each item of trading stock includes all direct and indirect expenditure incurred in relation to the item in bringing the item to its present location and condition up to the time that the item is located in its final selling location.' Paragraph 7 of TR 2006/8 specifies the types of trading stock related expenses that are included as part of the 'cost' of trading stock on hand. The valuation methodology prescribed by TR 2006/8 is supported by court decisions and is consistent with accounting principles and conventions. An amount legally 'incurred' for the purposes of section 8-1 of the ITAA 1997 cannot be taken to be 'not-incurred' simply because a different amount is treated as an accounting expense under accounting principles and conventions.
30	Entity 2	It is inappropriate to require the company to include rebates and discounts as ordinary income in advance of the sale of the stock to which they relate. 'This becomes obvious if the retailer has not sold the stock and it has the stock on hand at year end. It is anomalous to return rebates and discounts as ordinary income when the only activity was the purchase of the stock.'	It is clearly not the case that a trade incentive is ordinary income of the buyer where 'the only activity was the purchase of the stock.' Where a trade incentive is provided for a specific purpose the character of the incentive and its income treatment will be determined by that purpose.
31	Entity 2	The ATO view ignores the substantive issue of whether a settlement discount is paid by a supplier as a reduction of cost or whether it is directed at another	The Tax Office does not agree. Under the terms of trade between a buyer and a seller a settlement discount is given in relation to the early settlement of a debt. The Tax Office accepts that in certain

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		purpose.	circumstances a settlement discount may be treated by a seller in accordance with the *Ballarat Brewing* decision for the purposes of determining the sale proceeds of the seller. However the *Ballarat Brewing* decision is not concerned with the reasons why a settlement discount is offered. The Ruling provides guidance on this issue.
32	Entity 2	Example 2: • 'Clearly there is 'virtual certainty' of the rebate in that the supplier charges and retailer pays the net amount before the threshold was reached.' • 'It is difficult to see how a volume rebate can be anything other than an amount that is intended in reality as a direct reduction to the purchase price. The retailer's only activity was to purchase stock and there was no other income producing activity other than the purchase of the stock.'	Paragraph 5 of the final Ruling states that > An incentive that is subject to a condition that has not been satisfied at the time of the purchase does not relate directly to the purchase of trading stock and does not reduce the cost of acquiring trading stock for a buyer. The Tax Office comments in relation to Issue 26, including the extract from TR 96/20, are equally relevant here.
33	Entity 2	Promotional rebates. As stated by the Urgent Issues group (UIG) … > where the promotional rebate is provided as a percentage off the cost of purchases for general on going promotion throughout the year, it is difficult to argue that the retailer is being compensated for specifically identifiable activities, which can be separately measured.	The particular character of a promoter needs to be recognised for income tax purposes. The views of the UIG in an accounting context are not relevant to the legal character of a payment in the hands of the recipient of the payment.
34	Entity 2	Transport rebate – Example 11: • 'The ATO should explain the difference between a 'transport rebate' and a 'volume based promotional rebate'. In both cases the supplier is committed to pay the rebate upon the retailer's purchase of the stock.'	The difference between transport rebate and a promotional rebate seems clear. A transport rebate is connected with the transport of trading stock whereas a promotional rebate is given in consideration for promotional activities undertaken by the buyer for the benefit of the seller. The distinctions drawn in example 11 are clear.

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		• 'There is no material difference between a volume based transport rebate and a volume based promotional rebate.'	Whether or not a rebate 'is merely a contribution to the overall transport and distribution cost [and] either a reduction in that cost or ordinary income', or whether 'the amount of the rebate can be directly linked to and is dependent on the number of units purchased [and] would be treated as a reduction in the cost of acquisition of trading stock' is a question of fact to be answered having regard to all relevant circumstances. This is not something that the Tax Office can explain in a public ruling.