TD 98/D6 - Income tax and fringe benefits tax: what are the taxation consequences of certain motor vehicle lease novation arrangements known as partial novations?

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Draft Taxation Determination

Income tax and fringe benefits tax: what are the taxation consequences of certain motor vehicle lease novation arrangements known as partial novations?

1. The income tax consequences for employees with full novation lease arrangements and lease payment assumption arrangements are outlined in Taxation Ruling IT 2509 and Taxation Determination TD 95/63.

Full novation

2. As described in IT 2509, a full novation occurs where the novation agreement has the effect of transferring the rights and obligations of the lessee under a lease from the employee to the employer **and** the original agreements, being a finance lease and/or a sublease, are rescinded. A full novation may also be effective where it includes an agreement to enter into a further novation on termination or expiry of the novated lease.

Partial novation

3. A partial novation usually occurs where an employee leases a vehicle from a financier and subleases it to an employer. Under the partial novation the employee, the finance company and the employer agree that the obligation to make the lease payments is transferred to the employer. As consideration for the sublease, the employer agrees to make the lease payments direct to the financier. The head lease contract remains intact and is not rescinded. Consequently, partial novations are not covered by IT 2509.

4. Under these arrangements, the provision of a motor vehicle by an employer to an employee gives rise to a car fringe benefit. However, as both the lease and the sublease remain operative, the employee as lessee is assessable on the lease payments made by the employer (section 19 of the *Income Tax Assessment Act 1936* (ITAA 1936) and subsections 6-5(4) and 6-10(4) of the *Income Tax Assessment Act 1997* (ITAA 1997)). Note that the employee is not entitled to a deduction for lease payments forming part of these arrangements (subsection 51(1) (section 8-1 of the ITAA 1997), section 51AF and subsection 42A-50(3) of the ITAA 1936).

5. Where the lease payments made by the employer are not made as part of a sublease arrangement, an expense payment fringe benefit arises. In such a case, the employee is not assessable on the lease payments (paragraph 23L(1)(a) of the ITAA 1936).

6. Note that where there is an employment arrangement that provides an employee with the right to use a leased motor vehicle, the employment arrangement may constitute a lease or sublease

between the employer and the employee in certain circumstances (see, for example, the definition of a lease in section 42A-115 of the ITAA 1936).

Date of effect

7. There has been some misunderstanding about the practice of applying IT 2509 to partial novation arrangements, resulting in a view that the employee in these arrangements would not be assessable as fringe benefits tax had been paid.

8. In light of these circumstances, no adjustment is to be made to an employee's taxable income for any income derived under partially novated motor vehicle lease arrangements for non-luxury cars. This decision applies to arrangements entered into before the issue date of this draft Taxation Determination, provided they continue in their current form and substance. Partially novated luxury car lease arrangements are subject to the luxury car rules in Schedule 2E of the ITAA 1936 (from 20 August 1996).

9. This Determination does not apply to the extent that it conflicts with the terms of settlement of a dispute agreed to before the issue date of the Determination or to any private ruling given on this matter before the issue date.

Your comments

10. If you want to comment on this draft Determination, please send your comments by **Friday 17 July 1998** to:

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Commissioner of Taxation
17 June 1998

FOI INDEX DETAIL: Reference No.

Related Determinations: TD 95/63

Related Rulings: IT 2509

Subject Ref: car fringe benefits; deductions and expenses; expense payment fringe benefits; FBT arrangement; FBT salary packaging; FBT statutory formula; fringe benefits; fringe benefits tax; income tax; lease financing; lease residual values; luxury vehicles; sub leasing

Legislative Ref: ITAA36 19; ITAA36 23L(1)(a); ITAA36 42A-50(3); ITAA36 42A-115; ITAA36 51(1); ITAA36 51AF; ITAA36 Schedule 2E; ITAA97 6-5(4); ITAA97 6-10(4); ITAA97 8-1

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