

IT 2432 - Income tax : factoring of debts

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TAXATION RULING NO. IT 2432

INCOME TAX : FACTORING OF DEBTS

F.O.I. EMBARGO: May be released

REF N.O. REF: 83/6090 Pt.2 DATE OF EFFECT:

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F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1206501	FACTORING OF DEBTS	25(1)
	ASSIGNMENT OF DEBTS OF	51(1)
	MEDICAL PRACTICE	260
	FAMILY TRUST - DEBTS	
	ASSIGNED TO	

OTHER RULINGS ON TOPIC IT 276

PREAMBLE In a decision reported as Case S15, 85 ATC 181; 28 CTBR(NS), Case 25, Taxation Board of Review No. 1 allowed income tax deductions to a medical practitioner for administrative service fees and factoring fees paid to the trustee of a family trust.

2. An appeal was lodged in the Supreme Court of New South Wales against that part of the decision which related to the factoring fees. In the events that transpired and after the appeal had been heard and the decision reserved the taxpayer consented to the appeal being allowed, i.e. he consented to the income tax deductions allowed by the Taxation Board of Review in respect of the factoring fees being disallowed.

FACTS 3. The taxpayer and the trustee of the family trust entered into a written debt factoring agreement in October 1977. Under the agreement the trustee company agreed to purchase all the uncollected debts of the taxpayer's practice at a discount of 8%. The agreement provided for the trustee company to pay the taxpayer 92% of the face value of the debts. The taxpayer was to collect the debts on behalf of the trustee company.

4. The agreement was implemented by the taxpayer calculating at the end of each week the total amount of accounts rendered by the practice which had not been paid in cash. On each Friday a cheque was drawn in favour of the taxpayer by the trustee company for 92% of this amount. Outstanding fees subsequently collected by the taxpayer were deposited into the trustee company's bank account. Generally the taxpayer's patients paid their accounts within 45 days and bad debts were negligible.

5. The trustee company was initially placed in funds to acquire the uncollected debts for the first week by obtaining a loan of \$5,000 from the taxpayer's wife. When the weekly arrangement commenced there was a delay in implementing it

because the trustee company had insufficient funds to immediately make purchase payments on the debts assigned.

6. The disallowance of the income tax deductions for factoring fees had its origin primarily on the basis that, notwithstanding the agreement of 1977, there was not any alteration to the manner in which fees owing to the taxpayer were collected. Accounts were still sent out in his name and accounts unpaid at the end of each week were subsequently paid to him. There was not any outward indication of the existence of the factoring arrangement, i.e. the trustee did not intervene in any debt collecting activity. Furthermore, the taxpayer could not point to any commercial advantage for the arrangement. On the contrary, it was considered that the discounting fee of 8% was excessive in the light of the fact that accounts were generally paid within 45 days and bad debts were negligible.

7. Against this background it was considered that the factoring fees ought not be allowed as income tax deductions under sub-section 51(1). They were not considered to be losses and outgoings brought about by the operation of the taxpayer's medical practice but rather they were considered to be distributions of income from the practice to family members. In terms of sub-section 51(1) they were precluded from deduction as losses and outgoings of a private or domestic nature. Furthermore, in any event the factoring arrangement was one to which section 260 applied. The taxpayer's subsequent consent to the factoring fees being disallowed as income tax deductions is seen as recognition of the force of these considerations.

RULING

8. The approach of this office to debt factoring arrangements is outlined in Canberra Income Tax Circular Memorandum No. 827 (CM827). Although the CM deals with debt factoring arrangements entered into between parties at arm's length there is not any reason to suggest that parties not at arm's length are disqualified from entering into debt factoring arrangements. Each case must be examined in the light of its own facts. The present case illustrates the sorts of considerations which must be taken into account in determining whether income tax deductions ought to be allowed for debt factoring fees arising out of non-arm's length arrangements and the need for the arrangements to be explicable by reference to ordinary business or commercial standards.

COMMISSIONER OF TAXATION
23 July 1987