IT 2594 - Income tax: basis of assessment of income from chattel leasing transactions

TAXATION RULING NO. IT 2594

INCOME TAX: BASIS OF ASSESSMENT OF INCOME FROM CHATTEL LEASING TRANSACTIONS

F.O.I. EMBARGO: May be released

REF N.O. REF: 85/3378-4 DATE OF EFFECT: 1 July 1990

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F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1012013	INCOME FROM CHATTEL LEASING	25(1)
	DEPRECIATION	54

OTHER RULINGS ON THIS TOPIC : IT 2105, IT 2162, IT 2166, IT 2376

PREAMBLE This Ruling deals with the basis of calculating income from genuine chattel leasing transactions which are not subject to the application of section 51AD or Division 16D of Part III (Sections 159GE to GO) of the Income Tax Assessment Act 1936 (the Act). Taxation Ruling Nos. IT 2162 and IT 2166 on this topic are withdrawn in respect of transactions entered into after the date of effect of this Taxation Ruling.

2. The statutory basis for calculating income from genuine chattel leasing transactions is gross rentals less deductions by way of depreciation and balancing adjustment on disposal, sometimes referred to as the "asset method". The option of calculating taxable income from finance leases on the finance or actuarial accounting method ("finance method") in place of the asset method was accepted and restated in Taxation Ruling Nos. IT 2162 and IT 2166 subject to certain conditions and assumptions. Those conditions and assumptions included the following:

(a) that the amount of taxable income from the leasing transaction over the period of the lease would be equivalent to the amount calculated under the asset method;

(b) that income from all chattel leasing transactions of a lessor (including a company group) would be calculated on the same basis; and

(c) that the lease was genuine in terms of Taxation Ruling No. IT 28.

3. The option of calculating taxable income in accordance with the finance method was granted in response to taxpayers' requests to use the same method of accounting for income as they use in their published accounts.

4. Since acceptance of the finance method there have been a number of significant amendments to the law in connection with depreciable property. These amendments which include the introduction of section 57AF, Division 16D and section 57AL (now repealed) have affected the calculation of taxable income in respect of finance leasing transactions. In relation to Section 57AF, which limits the cost of a motor vehicle for depreciation purposes, it was considered necessary to adjust the taxable income of a lessor using the finance method to reflect the depreciation cost limit (see Taxation Ruling No. IT 2105).

5. The finance method may also produce significant differences in taxable income on an annual and overall basis where the variables underlying the calculations for each method differ. For example, variations between the residual value and the written down value produce a difference in taxable income on an annual basis. In sale and leaseback arrangements the overall taxable income will differ because of the application of section 60 (see Taxation Ruling No. IT 2354).

6. Representations have been received on behalf of lessors seeking a review of Taxation Ruling Nos. IT 2162 and IT 2166. It has been submitted that the present restriction on lessors within a company group from varying the method of calculating the lessor's income has led to distortions and inequities in the leasing market. It is said that inequities have increased markedly since the repeal of the accelerated depreciation rates (section 57AL).

7. In the circumstances it has been necessary to review the basis for acceptance of the finance method of calculating taxable income to ensure the statutory correct amount of taxable income is brought to account each year.

RULING

8. In view of the matters set out in paragraphs 4 to 6, it has been decided that the finance method of accounting for lease income will no longer be accepted. In all cases the taxable income should be calculated in accordance with the asset method. This method is the only method which will ensure the statutory correct amount of taxable income is brought to account each year.

9. Taxation Ruling No. IT 2105 which deals with the motor vehicle depreciation limit under the finance method will, therefore, not be applicable to transactions entered into from the date of effect of this Ruling.

10. Arrangements which are not genuine leases, for example, leases with options to purchase or leases for the substantial life of the property, are subject to the application of Division 16D, Division 16E or section 128AC, as appropriate. The question of what constitutes a genuine lease is considered in Taxation Ruling Nos. IT 28 and IT 2051.

11. This Ruling will apply to all chattel leasing transactions entered into on or after 1 July 1990.

COMMISSIONER OF TAXATION
14 June 1990

APPENDIX

ADDENDUM

Some lessors have indicated that they are unable to comply with the transition to the asset method by 1 July 1990 because substantial changes have to be made to their existing administrative systems.

2. If a lessor requires further time to ensure an orderly transition to the asset method, an extension of one month will be allowed. In such cases, this Ruling will apply to chattel leasing transactions entered into on or after 1 August 1990. It will not be necessary for lessors in this position to make any application in order to receive the extension of time.

3. The extension will not apply to sale and leaseback transactions in respect of used property.

COMMISSIONER OF TAXATION
29 June 1990