

# ***TR 2006/13 - Income tax: sale and leasebacks***

 This cover sheet is provided for information only. It does not form part of *TR 2006/13 - Income tax: sale and leasebacks*

 This document has changed over time. This is a consolidated version of the ruling which was published on *10 January 2007*



# Taxation Ruling

## Income tax: sale and leasebacks

---

|                                     |            |
|-------------------------------------|------------|
| Contents                            | Para       |
| <b>LEGALLY BINDING SECTION:</b>     |            |
| <b>What this Ruling is about</b>    | <b>1</b>   |
| <b>Ruling</b>                       | <b>10</b>  |
| <b>Date of effect</b>               | <b>43</b>  |
| <b>Previous Rulings</b>             | <b>44</b>  |
| <b>NOT LEGALLY BINDING SECTION:</b> |            |
| <b>Appendix 1:</b>                  |            |
| <b>Explanation</b>                  | <b>45</b>  |
| <b>Appendix 2:</b>                  |            |
| <b>Alternative views</b>            | <b>107</b> |
| <b>Appendix 3:</b>                  |            |
| <b>Detailed contents list</b>       | <b>110</b> |

### **📌 This publication provides you with the following level of protection:**

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

*[Note: This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]*

## What this Ruling is about

---

1. This Ruling concerns financing arrangements taking the form of sale and leaseback arrangements. The Ruling explains the taxation consequences of sale and leaseback arrangements which involve depreciating assets<sup>1</sup> subject to Division 40 of the *Income Tax Assessment Act 1997* (ITAA 1997).

2. The taxation consequences described in the Ruling apply to arrangements that are correctly characterised as a sale and leaseback. Although the character of a transaction will generally follow its legal form, it is necessary to consider whether the true legal characterisation is that of a sale and leaseback, by examining what the transaction effects having regard to the legal rights and obligations conferred on the parties.

### **Class of entities/scheme**

3. This Ruling applies to sale and leaseback arrangements involving depreciating assets.

---

<sup>1</sup> A depreciating asset is an asset with a limited effective life which can reasonably be expected to decline in value over the time it is used, and excludes land, items of trading stock and intangible assets, unless specifically listed: see section 40-30 of the ITAA 1997. Improvements to land and fixtures (apart from capital works to which Division 43 of the ITAA 1997 applies) whether removable or not can still qualify as depreciating assets.

4. A sale and leaseback arrangement is typically a two party arrangement under which the owner of an asset (referred to in the Ruling as the lessee) disposes of the asset, usually by way of sale of the asset (or by disposing of rights to or including rights to the asset), but continues to use it as lessee (or bailee) under a lease (or bailment or licence) from the acquirer (referred to in the Ruling as the lessor).

5. For the purposes of this ruling, a sale, sufficient to support a leaseback of the asset, may also be taken to have occurred if the lessor provides the lessee with consideration in exchange for a sufficient equitable interest in the asset.<sup>2</sup>

6. The leasing component of the arrangement would ordinarily involve periodic payments by the lessee to the lessor, in return for the right to possess and use the asset exclusively during the term of the lease.

7. This Ruling does not address the tax consequences of arrangements which also include an option or an obligation for the lessee to reacquire the asset at the end of the lease term. Such arrangements would carry different tax consequences from the usual tax treatment explained in this ruling, and may attract the application of Division 240 of the ITAA 1997.<sup>3</sup>

7A. Similarly, this Ruling does not apply to arrangements that include luxury car leases. Such arrangements give rise to special tax consequences under Division 42A of Schedule 2E of the *Income Tax Assessment Act 1936* (ITAA 1936).

### **Effect of sale and leaseback arrangements**

8. Sale and leasebacks are recognised in the ITAA 1936 and the ITAA 1997 as transactions capable of having a tax effect: subsection 82AB(7) and Division 16D of Part III (note also section 51AD and subsection 57AM(33)) of the ITAA 1936; subsection 40-65(3) of the ITAA 1997.

9. In substance, sale and leaseback arrangements have a similar economic effect to providing a loan to the lessee. From this point of view, there is a discount rate at which the present value of the lease payments and the residual value of the asset equals the cost of the asset to the lessor. That discount rate 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 the rate and timing of tax deductions allowable to the lessor and allowable to the lessee as a result of the arrangement.

---

<sup>2</sup> See *Eastern Nitrogen Ltd v. Commissioner of Taxation* (2001) 108 FCR 27; 2001 ATC 4164; (2001) 46 ATR 474 and *FC of T v. Metal Manufactures Ltd* (2001) 108 FCR 150; 2001 ATC 4152; (2001) 46 ATR 497 for an example of this type of arrangement.

<sup>3</sup> Division 240 applies to arrangements, in respect of goods, that satisfy the definition of 'hire purchase agreement' in section 995-1 of the ITAA 1997: see section 240-10. If Division 240 were to apply to a sale and leaseback arrangement, the leaseback component would be re-characterised as a notional sale accompanied by a notional loan.

## Ruling

---

### **Usual tax treatment of sale and leasebacks**

10. Where an arrangement is legally characterised as a sale and leaseback involving a depreciating asset<sup>4</sup> subject to Division 40 of the ITAA 1997, the taxation consequences will be as outlined immediately below, unless there are particular circumstances suggesting an alternative tax treatment: see paragraphs 18 to 20 and 24 to 42 of this Ruling.

### ***Balancing adjustments***

11. When a depreciating asset is sold, the lessee stops holding the asset under Division 40 of the ITAA 1997, and a balancing adjustment event occurs: section 40-295 of the ITAA 1997. If the sale price (most commonly the termination value for the purposes of Division 40) is more than its adjustable value immediately before the sale, the balancing adjustment event results in the difference being included in the lessee's assessable income: subsection 40-285(1) of the ITAA 1997. Where the termination value is less than the adjustable value, the difference is an allowable deduction for the lessee: subsection 40-285(2) of the ITAA 1997. These adjustments result equally from sales forming part of sale and leaseback transactions as from other balancing adjustment events.

### ***Deductions for decline in value***

12. When the lessor in a sale and leaseback is the legal owner of the asset, they hold the depreciating asset according to item 10 of the table in section 40-40 of the ITAA 1997. The lessor may also hold the asset according to item 4 of that table (where the asset is a fixture on someone else's land but the lessor has the right to recover the asset). The lessor, as a holder of the asset according to section 40-40, is entitled to claim a deduction equal to the decline in value of the asset.

13. The lessor's deduction for decline in value will be based on the cost of the asset to the lessor (ordinarily, the price paid under the sale to the lessor), not the cost to the lessee.

---

<sup>4</sup> Note: An asset in respect of which deductions can be claimed under Subdivision 40-F or 40-G of the ITAA 1997, which are relevant to primary producers, is unlikely to be subject to a sale and leaseback arrangement. Such assets cannot be depreciated under the general capital allowances provisions (see section 40-50) and only the taxpayer carrying on the primary production or horticultural business (that is the lessee) is entitled to a deduction under those Subdivisions. An exception to this is in respect of water facilities to which Subdivision 40-F applies, which are held by an irrigation water provider.

**Lease payments**

14. The lease back of the asset ordinarily requires specified periodic payments by the lessee to the lessor. The lessee will incur and deduct them, and the lessor will derive them as income, on the same basis as for any lease of a similar asset on similar terms where there is no related sale of the asset to the lessor.

15. Normally a lessor would return income from a lease, including a lease that forms part of a sale and leaseback, by returning the lease payments as assessable income and deducting from that income the deductions for decline in value and any other deductions (the asset method of returning lease income): see Taxation Ruling IT 2594. *FC of T v. Citibank Ltd and Ors* (1993) 26 ATR 423; 93 ATC 4691 (*Citibank*) 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. The lessee may have to make additional payments to the lessor to make up the residual value of the asset to a required level (generally on expiry or termination of the lease). In the ordinary case, such make-up payments would also be income of the lessor, and deductible to the lessee. These payments are regarded as being on revenue account because they take their character from the item being adjusted, ie, the lease payments.<sup>5</sup>

**Proceeds of sale by lessor**

16. When the lease ends, the lessor may sell the asset and a balancing adjustment event will then occur for a lessor who has been the holder of the asset. An amount will be included in the lessor's assessable income, or a deduction will be allowed to the lessor, depending on whether the termination value is greater than or less than the adjustable value.

17. If, at the end of the lease, such a lessor takes possession of the depreciating asset, then they continue to hold the asset for the purposes of Division 40 of the ITAA 1997. The lessor may be able to continue to claim deductions for the decline in value of the asset, provided they continue to use it for a taxable purpose. If the lessor continues to hold the asset but ceases to use it for any purpose, then a balancing adjustment event may occur: see paragraph 40-295(1)(b) of the ITAA 1997.

**Alternative tax treatments**

18. In some situations, the general tax treatment of sale and leaseback arrangements is altered. For example, where a sale and leaseback arrangement involves depreciating assets that are fixtures, the calculation of deductions for decline in value may be different: see paragraphs 25 to 33 of this Ruling.

---

<sup>5</sup> See *Commissioner of Taxation v. Morgan* (1961) 106 CLR 517.

19. A different tax treatment will also result where a sale and leaseback arrangement includes a right of, or an obligation on, the lessee to repurchase the asset at the end of the lease. For example, where the leaseback component of what would otherwise be a sale and leaseback arrangement is properly described as a hire purchase arrangement<sup>6</sup> in respect of goods, Division 240 of the ITAA 1997 may treat the leaseback as a sale and loan and the lessee and lessor as a notional buyer and notional seller respectively. Arrangements including such a right or obligation of repurchase, which give rise to alternative tax treatments, are not covered by this Ruling.

20. In some cases, a profit or gain derived by the lessee on disposal of the asset may constitute income apart from the balancing adjustment provisions. This will be so if the circumstances described by the High Court in *Federal Commissioner of Taxation v. Myer Emporium Ltd* are satisfied:

...the fact that a profit or gain is made as the result of an isolated venture or a 'one-off' transaction [does not] preclude it from being properly characterised as income: *FCT v. Whitfords Beach Pty Ltd* (1982) 12 ATR 692 at 698-9, 705; 150 CLR 355 at 366-7, 376. The authorities establish that a profit or gain so made will constitute income if the property generating the profit or gain was acquired in a business operation or commercial transaction for the purpose of profit-making by the means giving rise to the profit.<sup>7</sup>

### **Sale value**

21. 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, the market value will ordinarily be ascertainable by reference to factual information in that market at the time the sale is made.

---

<sup>6</sup> According to the definition in section 995-1 of the ITAA 1997. State legislation on hire purchase agreements may well apply on a more limited basis, for instance, by not applying to fixtures.

<sup>7</sup> (1987) 163 CLR 199 at 209-210; 18 ATR 693 at 697; 87 ATC 4363 at 4367.

22. Where no such market exists, the Commissioner will accept the adjustable value<sup>8</sup> of the asset to the vendor lessee at the time of sale as its market value. If a sale price is significantly above or below that adjustable value, it should be based on an independent appraisal of the value of the asset. In the case of a major asset, an appraisal in the form of an independent valuation by a qualified valuer would provide evidence that the sale price properly reflects the market value. The valuation should be of the value of the asset separated from the business to which it is leased, because, if the lessor were to exercise rights against the lessee to take possession of the asset on default, this would be the value for which the asset could be sold by the lessor (compare alternative view at Appendix 2).

23. If an expected 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 to the extent that the expected sale price is less than the actual market value. However, the Commissioner will accept an up-front valuation of the expected market value of the asset at the end of the lease, provided such valuation is made bona fide, and based on independent evidence or set no lower than in accordance with Taxation Ruling IT 28 and Taxation Determination TD 93/142. In any case, the termination value, for the purposes of calculating any balancing adjustments arising at the end of the lease, will be determined under sections 40-300 or 40-305 of the ITAA 1997.

### **Circumstances where sale and leasebacks may have a different tax effect**

24. There may be circumstances where arrangements entered into as sale and leaseback transactions have tax consequences different from those outlined at paragraphs 10 to 17 of this Ruling.

### **Where the asset is a fixture**

25. 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 so cannot actually be sold separately from it without being removed from the land. However, it is possible for a landowner to create an equitable interest in relation to a fixture by a sale and leaseback transaction, sufficient to support the landowner's obligation to make deductible payments to the lessor for leaseback of that fixture: see *Commissioner of Taxation v. Metal Manufactures Ltd (Metal Manufactures)* 46 ATR 497 at 510; 2001 ATC 4152 at 4163 and *Eastern Nitrogen Ltd v. Federal Commissioner of Taxation (Eastern Nitrogen)* 46 ATR 474 at 484-485, 2001 ATC 4164 at 4173.

---

<sup>8</sup> The adjustable value of a depreciating asset is generally its cost less its decline in value up to the relevant point in time: see section 40-85 of the ITAA 1997.

26. Where a sale and leaseback arrangement involves a depreciating asset that is affixed to land that the lessee owns, the tax consequences are set out immediately below.

27. For the purpose of applying the capital allowance provisions, the asset is ordinarily held according to the following sequence:

- (a) When the lessee sells the depreciating asset, the lessor becomes the holder under item 6 of the table in section 40-40 of the ITAA 1997, to the exclusion of the lessee, if they have a right as against the lessee to possess the asset immediately. The lessee simultaneously ceases to hold the depreciating asset, being excluded by item 6.
- (b) When the parties then enter into a leaseback agreement, the lessor no longer has the right to possess the asset immediately, and ceases to hold the asset under item 6 of the table in section 40-40.
- (c) The lessor now holds the asset under item 4, which provides that the lessor of a depreciating asset that is fixed to land, and who has a right to recover the asset, is a holder of the asset, but not to the exclusion of any other holders under the table in section 40-40. Note, the lessor is not the legal owner of the asset: see *Bellinz Pty Ltd & ors v. FC of T* (1998) 39 ATR 198; 98 ATC 4634. Also see *Melluish (Inspector of Taxes) v. BMI (No. 3) Ltd* [1996] AC 454 at 475-6.
- (d) As item 6 no longer applies in respect of the lessor's holding, the lessee is not excluded from also holding the asset as its legal owner (being the legal owner of the land to which the asset is affixed). Therefore, the lessee begins to hold the depreciating asset under item 10 of the table in section 40-40.

28. When the initial sale occurs (and before the leaseback begins), the lessee ordinarily ceases to hold the asset (see paragraph 27(a) of this Ruling) and therefore at that moment the lessee has a balancing adjustment event. Once the lease is entered into, the lessee begins to hold the asset again (see paragraphs 27(b) and 27(d) of this Ruling), while the lessor's holding continues, albeit according to a different item in the table in section 40-40.



29. During the lease, there is more than one holder of the asset, and section 40-35 of the ITAA 1997 applies. Section 40-35 effectively treats the interest that each holder has in the asset as if that interest were itself the asset. Each holder may therefore be entitled to claim a deduction for the decline in value of their interest in the asset, worked out by reference to their cost of their interest in the asset. (In practice, the lessee's cost, and therefore their deductions for decline in value, will commonly be zero, as they have not usually made any payment to hold the asset, except for non-capital lease payments, which are excluded from cost by section 40-220 of the ITAA 1997. But in some cases a lessee will incur further capital expenditures after the lease begins on the asset they hold and may have a cost, and so deductions for decline in value will be available.)

30. In the ordinary case, lease payments are deductible to the lessee: see *Eastern Nitrogen* and *Metal Manufacturers*. The lease payments will also ordinarily constitute assessable income in the hands of the lessor.

31. What happens at the end of the lease can affect how the entire arrangement is treated at law. If the arrangement includes an option or an obligation or contingent obligation for the lessee to repurchase the asset, then the lease may be characterised as a hire purchase agreement: see Division 240.

32. In circumstances where a sale and leaseback takes place when the lessee is not the legal owner of the land to which a depreciating asset is affixed, and/or when another person has proprietary rights in respect of the land, the lessor's right to recover the asset may be limited or excluded by the rights of the third party. If the lessor does not have the right to recover the asset as against a third party, then the lessor can not be a holder of the asset for the purposes of item 4 of the table in section 40-40. In those circumstances, the lessor will not be entitled to any deductions for decline in value of the asset during the lease.

33. The Commissioner may also, in some circumstances, argue that Part IVA of the ITAA 1936 applies to a sale and leaseback arrangement involving a fixture. While the cases of *Metal Manufacturers* and *Eastern Nitrogen* establish that sale and leaseback arrangements involving fixtures will not necessarily attract the operation of Part IVA, the Commissioner may consider applying Part IVA where an arrangement exhibits any of the features outlined in paragraph 37 of this Ruling. However, cases whose only material facts are in line with those in *Metal Manufactures* and *Eastern Nitrogen* will not be affected by Part IVA. See paragraphs 84 to 102 of this Ruling for further discussion of these issues.

**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**

34. Section 51AD of the ITAA 1936 may apply to deny deductions to a lessor in respect of a sale and leaseback of an asset in certain circumstances. These circumstances are where the acquisition of the asset by the lessor was predominantly funded by effectively non-recourse debt where 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 at that time, no arrangement existed whereby that asset would be sold and leased back to the lessee.

**Sham transactions**

35. 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, in rare circumstances, 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, that is, 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.

36. In each case the totality of the facts need to be considered to determine the intention of the parties. However, it may be 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 not a legally valid sale and leaseback arrangement.

**Part IVA**

37. In most situations, sale and leasebacks will be explicable on the basis of a dominant purpose of obtaining a benefit other than a tax benefit, for both lessees and lessors. However, some transactions may have particular steps which may raise a real concern that the transaction, or part of it, has a dominant purpose of securing a tax benefit such that Part IVA of the ITAA 1936 may apply. See Law Administration Practice Statement PS LA 2005/24 Application of General Anti-Avoidance Rules. Aspects of sale and leaseback transactions which are likely to raise concerns include:

- (a) an appropriate balancing adjustment 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 21 to 23), 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 (other than the effect of investment and/or development allowance) : see Taxation Rulings IT 2220 and IT 2051; or
- (e) the sale and leaseback arrangement does not effectively provide the full value of the purchase price of the asset to the vendor lessee when the asset is sold for leaseback.

38. Taxpayers can apply to the Commissioner for a private ruling in respect of whether or not Part IVA of the ITAA 1936 applies to a particular arrangement. 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 21 to 23 of this Ruling). PS LA 2005/24 gives practical guidance on the processes and procedures involved in applying to the Commissioner for a Ruling on the application of Part IVA.

39. Where a tax benefit as defined in subsection 177C(1) of the ITAA 1936 is identified in connection with a scheme, it is 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 require 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.

40. However, there may be cases where the weighing up of all the facts (including any or all of the factors noted at paragraph 37 of this Ruling) could lead to a conclusion that the dominant purpose is to obtain a tax benefit. A more detailed explanation of how such a conclusion is reached can be found in PS LA 2005/24 at paragraphs 79 to 91.

41. An example of a relevant factor may be where deductions for decline in value or other deductions related to ownership represent substantially the overall benefits obtained by a lessor or shared by the parties. 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 adjustment amount which reflects the termination value of the asset (less its adjustable value) is not included in assessable income (see paragraph 11 of this Ruling).

42. In those cases where Part IVA of the ITAA 1936 applies, the Commissioner would have to determine what tax benefits of which taxpayers could reasonably be expected, but for the scheme, not to have been obtained, and which of those tax benefits are to be cancelled, with what (if any) compensating adjustments. How the Commissioner would do this depends on the facts in each case.

## **Date of effect**

---

43. This Ruling applies to years of income 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 settlement of a dispute agreed to before the date of issue of the Ruling.

**Note:** When the Ruling issued as Draft Ruling TR 2006/D5, the date of effect of the final ruling was proposed to be from the date of release of the final ruling. However, the Commissioner considers that a date of effect prior to the final date of issue provides more certainty for taxpayers in respect of the period following the decisions in *Metal Manufactures* and *Eastern Nitrogen*, as well as the period following the rewrite of the capital allowances provisions, and is no less favourable to taxpayers than the previous view stated in TR 95/30.

## **Previous Rulings**

---

44. This Ruling revises and updates Taxation Ruling TR 95/30. Accordingly, TR 95/30 is withdrawn from the date of issue of this Ruling.

---

**Commissioner of Taxation**

1 November 2006

---

## Appendix 1 – Explanation

**ⓘ** *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

### Usual tax treatment of sale and leasebacks

45. In summary, the usual tax effect of a sale and leaseback involving a depreciating asset will be as follows:

- (a) the lessor is entitled to deduct an amount for the decline in value of the leased asset, or other deductions, as appropriate;
- (b) the lessor must return the lease payments as income; and
- (c) the lessee is entitled to claim the lease payments as a deduction in full.

46. A balancing adjustment event will occur if the termination value of the depreciating asset (the sale price) is different to the adjustable value immediately before the sale. Where the termination value is the greater amount, the balancing adjustment event results in an amount being included in the lessee's assessable income: subsection 40-285(1) of the ITAA 1997. Where the termination value is the lesser amount, the difference is an allowable deduction for the lessee: subsection 40-285(2).

47. The method the lessor uses to work out the decline in value must generally be the same method that the lessee used when the lessee held the asset prior to the lessor's acquisition: subsection 40-65(3) of the ITAA 1997. So the lessor must use the diminishing value method if the lessee formerly used it, or the prime cost method if the lessee formerly used it. (If no method was used by the lessee, or if the lessor cannot readily find out the lessee's method, the lessor must use the diminishing value method.)

48. For the purposes of calculating the decline in value, the relevant cost is the cost of the asset to the lessor, not the cost to the lessee. (In some circumstances that cost will be reduced to market value, where the sale and leaseback is not at arm's length and the sale price is more than the market value: item 8 of the table in subsection 40-180(2) of the ITAA 1997.) It is generally worked out, for the diminishing value method, according to the same effective life that the lessee used, or for the prime cost method, using an effective life equal to so much of the effective life the lessee was using as is yet to elapse: subsection 40-95(5) of the ITAA 1997. Where the effective life the lessee was using was 'capped', the effective life for the lessor is set under subsections 40-95(5B) or (5C) of the ITAA 1997.

49. Before 1 July 1990, the Tax Office accepted that lessors could return lease income under the finance method, in place of the asset method (that is gross rentals less decline in value and balancing adjustment on disposal), subject to other conditions and assumptions set out in Taxation Rulings IT 2162 and IT 2166. The Tax Office withdrew its recognition of the finance method for returning lease income with effect from 1 July 1990 by Taxation Ruling IT 2594 (although 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**

50. 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 Commissioner's view is that generally speaking the lessor's rights in respect of a leased asset would arise in circumstances where that asset would have to be separated from the business of the lessee, because the lease would have expired or because the lessee would be in default under the lease, and that a market value should reflect this fact where this is so.

51. Where there is an identifiable, recognised market for the asset, the market value will be the 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.

52. Where no ready market exists, the Commissioner will accept the adjustable value of the asset (as defined in section 40-85 of the ITAA 1997), unless the taxpayer reasonably believes the market value of the asset to be significantly different in the light of independent appraisal of that value. The Commissioner may be unable to reliably accept a sale price significantly above or below that adjustable value unless it is based on an independent appraisal of the market value of the asset, and reflects the likely value of the lessor's rights should the lessee default as discussed above (rather than valuing the lessor's rights on the basis of continuing compliance with the lease). Generally, therefore, valuation should be on the basis that the lessor takes possession of the asset and seeks to sell or lease it to someone other than the lessee. In the case of a major asset, such evidence would usually consist of an independent valuation by a qualified 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 so as to provide support for claimed values. 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.

53. If a market price for the asset at the end of the lease is assumed or specified for the purposes of the lease at the time the lease is entered into, it may not reflect the actual market value at the end of the lease. If the market price is less than the actual market value at the time of sale (that is, when the lease ends) the lease payments may have a capital component. This is because they may represent the purchase price of the asset to the extent of the difference between the market price and the actual market value. The Commissioner, however, will accept lease terms set by reference to an up front valuation of the expected market value of the asset at the end of the lease, provided such valuation is made bona fide and either based on independent evidence or set no lower than in accordance with Taxation Ruling IT 28 and Taxation Determination TD 93/142. Whatever the price at the end of the lease assumed in the lease, the termination value, for the purposes of calculating any balancing adjustments arising at the end of the lease, will be determined under sections 40-300 or 40-305 of the ITAA 1997.

#### **Where the transactions have a different tax effect**

54. In some circumstances, a sale and leaseback arrangement will have different consequences to those outlined above. Those circumstances are outlined below.

#### ***Hire purchase***

55. Division 240 of the ITAA 1997 has effect for the purposes of the ITAA 1997 and the ITAA 1936 other than the capital gains tax (CGT) provisions and the non-resident withholding tax provisions: see section 240-15. This Ruling does not discuss the operation of Division 240 or the interaction between the Division and other tax law. Taxation Ruling TR 2005/20 considers when a notional buyer who is taken to own goods under Division 240 will be taken to 'hold' a depreciating asset for the purposes of Division 40 of the ITAA 1997.

56. There may also be hire purchase type agreements that do not fall into Division 240, and for those transactions other issues, including the extent to which payments may have a capital character, remain relevant.

#### **Fixtures**

57. 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 without being removed from the land. For example, see *Mills v. Stokman* (1967) 116 CLR 61.

58. However, a fixture may be subject to a sale by and leaseback to the landowner taking effect as the transfer of an equitable interest against the landowner in the fixture. Such an arrangement may thereby give rise to similar taxation consequences as outlined above in respect of sale and leaseback arrangements generally, at least while the lessee remains the landowner or retains a right to remove the fixture as against the landowner: see paragraphs 10 to 17 and 45 to 49 of this Ruling.

59. The Full Federal Court considered the sale and leaseback of fixtures in the cases of *Eastern Nitrogen* and *Metal Manufactures* (both cited above). These appeals were heard and decided concurrently as they dealt with substantially the same questions of law.

60. In *Eastern Nitrogen*, the taxpayer had appealed against the finding of the primary judge that the equitable interest in an ammonia plant (the subject of the transaction) was not adequate for the financiers to assert rights of ownership which would have denied the taxpayer the use of the goods in the event that they failed to pay rent. The Full Court found in the taxpayer's favour, Carr J stating that:

...the learned primary judge erred in concluding that the appellant had never lost the right to possession of the ammonia plant. In my view, the correct characterisation is that it did lose that right, probably at common law, but certainly in equity, following execution of the Instalment Purchase Agreement when payment, constructive delivery and acceptance of 'the Goods' took place...<sup>9</sup>

61. The Court therefore found that the lease payments made by the taxpayer were deductible, because they secured the continued use and possession of the plant. The Court did not, however, consider the nature of the lessor's proprietary right insofar as it may have constituted 'ownership' for the purposes of claiming a deduction for depreciation under section 54 of the ITAA 1936.

62. It has been suggested that the equitable right the lessor gained under the arrangement in *Eastern Nitrogen* would not have been sufficient to allow the lessor to claim depreciation deductions under the previous provisions of the ITAA 1936. This argument is supported by the decision of the Full Federal Court in *Bellinz Pty Ltd & Ors v. FC of T*<sup>10</sup> (see also *Melluish (Inspector of Taxes) v. BMI (No. 3) Ltd*<sup>11</sup>).

<sup>9</sup> ATC 4164 at 4173; ATR 474 at 484.

<sup>10</sup> (1998) 39 ATR 198; 98 ATC 4634.

<sup>11</sup> [1996] AC 454 at 475-6.



63. However, in order to claim deductions for decline in value under the uniform capital allowances regime (contained in Division 40 of the ITAA 1997) the taxpayer must 'hold' the goods according to the table in section 40-40. The lessor of a depreciating asset that is fixed to land holds the asset while they have a right to recover the asset. Such a right includes a right against the owner, or a right dependent on another person's right against the owner, so long as it exists. For instance, the lessee may be the landowner. In that case, the lease may give the lessor a direct right against the landowner, the lessee, to remove the asset. Or the lessee may not be the landowner, but may have a right against the landowner to remove the asset. In that case, the lease may give the lessor an indirect right against the landowner to remove the asset, as the lessor will lose any right to remove the asset when the lessee's right to remove is lost. Item 4 of the table in section 40-40 relevantly provides:

Use this table to work out who holds a \*depreciating asset. An entity identified in column 3 of an item in the table as not holding a depreciating asset cannot hold the asset under another item.

Identifying the holder of a depreciating asset

| Item | This kind of depreciating asset   | Is held by this entity                         |
|------|---|--|
| 4    | A *depreciating asset that is subject to a lease where the asset is fixed to land and the lessor has the right to recover the asset | The lessor (while the right to recover exists) |

64. If the lessee is the legal owner of the land to which the asset is fixed, then the lessee is also the legal owner of the fixture and therefore holds the asset under item 10 of the table in section 40-40 of the ITAA 1997. Item 10 provides that the holder of any depreciating asset is 'The owner, or the legal owner if there is both a legal and equitable owner'.

65. In circumstances where more than one entity is a holder of a depreciating asset, the rule in section 40-35 of the ITAA 1997 applies. Section 40-35 provides:

(1) This Division and Divisions 328 and 775 apply to a \*depreciating asset (the *underlying asset*) that you \*hold, and that is also held by one or more other entities, as if your interest in the underlying asset were itself the underlying asset.

**Note:** Partners do not hold partnership assets: see section 40-40.

(2) As a result, the decline in value of the underlying asset is not itself taken into account.

**Example:**

Buford Corp owns an office block that it leases to 2 companies, Smokey Pty Ltd and Bandit Pty Ltd. Smokey and Bandit decide to install a fountain in front of the building.

They discuss it with Buford who agrees to pay half the cost (because the fountain won't be removable at the end of the lease). Smokey and Bandit split the rest of the cost between them.

Smokey and Bandit would each hold the asset under item 3 of the table in section 40-40 and Buford would hold it under item 10. They would be joint holders, so each would write-off its interest in the fountain.

66. The result of section 40-35 of the ITAA 1997 is that the lessor and the lessee must calculate any deductions for decline in value of the fixture as though the interest in the asset were itself the depreciating asset. In practice, the lessee will not usually claim any deductions for the decline in value of the depreciating asset, as the initial sale part of the arrangement results in a balancing adjustment event. The leaseback arrangement results in the lessee beginning to hold the asset as legal owner of the land to which the depreciating asset is affixed; however, the lessee's cost in respect of that holding is usually nil. Their cost cannot include any lease payments as these are not generally amounts of a capital nature: see section 40-220 of the ITAA 1997. The lessee could only claim deductions for decline in value in respect of further expenditures, such as the cost of any capital improvements made to the fixture at the lessee's cost after the beginning of the lease.

67. In all other respects, a transaction involving a fixture that can be legally characterised as a sale and leaseback, although not effective to transfer legal ownership of the asset to the lessor, will generally result in the same tax consequences as a sale and leaseback of any other asset.

68. Different tax consequences may arise in circumstances where a third party holds an interest in the land to which the asset is affixed. The lessor may not have a sufficient interest in the asset to support the leaseback, and the associated tax consequences (for instance because the vendor lessee has no general right against the third party to remove the asset). In these circumstances, the Commissioner would need to consider whether or not the lessor has the right to recover the asset as against the third party. If the lessor does not have that right, then it could not satisfy the requirements of item 4 of the table in section 40-40 of the ITAA 1997 (see above). In these circumstances, the lessor would be unable to claim any deductions for the decline in value of the asset.

69. In addition, if the lessor has no right to recover the asset, then the lessee could not assert that lease payments were made in respect of a right to possess and use the asset, as the lessor could not prevent such use or possession in case of default. The lessee's payments would then not be deductible for the reasons accepted by the Full Court of the Federal Court of Australia in *Eastern Nitrogen* (above).

70. In such circumstances it would still be necessary to consider whether the arrangement should be characterised as a loan or a form of hire purchase agreement and taxed as such, rather than a sale and leaseback.

71. It may be appropriate in circumstances where the lessee regains all rights to the asset at the end of the lease, to re-characterise the lease payments as having a capital component, such that only the notional interest component would be deductible.

72. Even where the relevant documentation properly reflects the characterisation of an arrangement as a sale and leaseback, the Commissioner may seek to apply Part IVA of the ITAA 1936 to some transactions involving fixtures if the dominant purpose of one of the parties in entering into the arrangement was to obtain a tax benefit. The application of Part IVA is further discussed at paragraphs 84 to 103 of this Ruling.

## **Section 51AD**

73. Section 51AD of the ITAA 1936 will affect certain sale and leaseback arrangements by denying all otherwise allowable tax deductions attributable to the ownership of property previously owned and used, or held for use, by an end user (such as a lessee). It only applies where the lessor's acquisition of the property is financed predominantly by what is effectively non-recourse debt.

74. Property sold and leased back within 6 months after it was first acquired by the lessee is not taken to have been sold and leased back for the purposes of section 51AD of the ITAA 1936, provided at the time the lessee first acquired the asset there was an arrangement for its sale and leaseback: subsection 51AD(6).

75. 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) of the ITAA 1936, to satisfy the claims of the creditors in the event of a default. See Taxation Rulings TR 96/22 and IT 2051.

### **Sham**

76. 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, while rare, 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 – that is, the purported 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 337, *Gould and Gould; Swire Investments Ltd* [1993] FLC 92-434, and *Snook v. London and West Riding Investments* (1967) 2 QB 786 at 802).

77. The inference that a transaction is a sham will require strong support from the circumstances of the arrangement, and cannot be inferred lightly.

### **Legal characterisation of the arrangement**

78. If an arrangement should be legally characterised as something other than a sale and leaseback, then the arrangement may have different tax consequences.

79. 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).

80. 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 or exceed 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.

81. However, 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.

82. The Full Federal Court in *Metal Manufactures* made it clear that a sale and leaseback transaction cannot be characterised as a loan when the legal documentation (given its intended effect) did not support that characterisation. Sundberg J, in that case, agreed with the reasoning of the primary judge, who stated:

there is no basis for concluding that the payments in question should be characterised otherwise than as payments made pursuant to the obligations imposed by the Lease in order to secure to the Taxpayer the right to use the Plant and Equipment free of any risk that the Bank might exercise such rights as it may have to the Plant and Equipment as owner, whether legal or equitable. There is no basis for concluding that the Arrangements should be treated as constituting a loan and the regular payments characterised as repayment of principal and payment of interest under such a loan.<sup>12</sup>

83. The legislation also includes specific provisions, such as section 51AD of the ITAA 1936, and Division 240 of the ITAA 1997, which are intended to operate when a transaction, although legally characterised in one way, should give rise to different tax consequences. As such, these provisions would be unnecessary if sale and leaseback transactions were always given a different legal characterisation and were recast at law as, for example, a sale accompanied by a hire purchase, rather than a sale and leaseback. Similarly, the existence of one or other of the features listed in paragraph 80 of this Ruling 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 ITAA 1936. In this regard see also Hill J in *FC of T v. Citibank Ltd and Ors* (1993) 26 ATR 423 at 435-6; 93 ATC 4691 at 4702.

<sup>12</sup> Cited above, ATR 375 at 424; ATC 5229 at 5273.

**Part IVA**

84. The general anti-avoidance provisions of Part IVA of the ITAA 1936 might apply even where the relevant documentation (given its intended effect) properly reflects the characterisation of the transactions as a sale and a leaseback.

**Scheme**

85. A scheme, for the purposes of Part IVA of the ITAA 1936, is widely defined in section 177A of the ITAA 1936. In *Federal Commissioner of Taxation v. Hart* (2004) 217 CLR 216; 2004 ATC 4599; (2004) 55 ATR 712 (Hart), Callinan J noted in respect of the definition of a scheme:

Read literally, the definition of a scheme is easily wide enough to include something much less than an agreement or arrangement: indeed to include an 'action', or 'course of action', or a promise made pursuant to, or as part of an agreement or arrangement, or of a scheme. A scheme, however it is to be described, must nonetheless be something which is, or can be the object of a particular, that is to say, a dominant purpose as required by s 177A(5). Further requirements are that what is sought to be identified as a scheme, must be something to which the matters referred to in s 177D(b) can or may be relevant.<sup>13</sup>

86. Subject to the facts of the case, a scheme could include a sale itself or a leaseback itself or both transactions together, although the latter would be the more common scenario. However identified, it is important to note the comments of Hill J in *Macquarie Finance Ltd v. Federal Commissioner of Taxation* (2004) 210 ALR 508; 2004 ATC 4866; (2004) 57 ATR 115, who pointed out:

Part IVA requires identification of the scheme as an important ingredient in the operation of the Part, if only because ... before a scheme can be one to which the provisions of the Part apply it must be possible to identify a tax benefit which has been obtained by the taxpayer in connection with the scheme. That is, the tax benefit which the Commissioner is authorised to cancel. The conclusion as to dominant purpose must be made by reference to the particular scheme and the tax benefit must be related to the scheme.<sup>14</sup>

87. The identified scheme must be one in connection with which a taxpayer has obtained a tax benefit. In the context of a sale and leaseback, it could include arrangements 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. It could also include arrangements which effectively ensure that the lessee will regain all rights to the asset at the termination of the lease, which would imply that the lease payments have a capital component in substance.

<sup>13</sup> ATC 4599 at 4624; ATR 712 at 741.

<sup>14</sup> ATC 4866 at 4884; ATR 115 at 137.

**Tax benefit**

88. A tax benefit exists for the purposes of Part IVA of the ITAA 1936 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 of the ITAA 1936. 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'.<sup>15</sup> This prediction is often referred to as a counterfactual. The High Court referred to it as the 'alternative postulate' in *Hart*.

89. It would be usual in sale and leasebacks for a relevant tax benefit to arise because of the availability of deductions for decline in value 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 deductions for decline in value 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, and the sale and leaseback has provided funds to the lessee, a reasonable counterfactual 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. Another counterfactual, 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 deductions for decline in value would not have been available to the lessor but for the scheme.

90. 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.

91. Moreover, 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 of the ITAA 1936 may technically arise.

---

<sup>15</sup> FC of T v. Peabody (1994) 28 ATR 334 at 353; 94 ATC 4663 at 4671.

***Dominant purpose***

92. Part IVA of the ITAA 1936 may apply even where the obtaining of a tax benefit is the objective dominant purpose of only one party to a scheme.<sup>16</sup> For this reason, lessors and lessees should consider the possibility of such a purpose on the part of a counterparty, legal/accounting adviser or other relevant party to a scheme.

93. The High Court in *Federal Commissioner of Taxation v. Spotless Services Limited* 34 ATR 183; 96 ATC 5201 provided some guidance with regard to ascertaining the dominant purpose in the context of a commercial transaction:

A person may enter into or carry out a scheme, within the meaning of Part IVA, for the dominant purpose of enabling the relevant taxpayer to obtain a tax benefit where that dominant purpose is consistent with the pursuit of commercial gain in the course of carrying on a business.

...

... A particular course of action may be ... both 'tax driven' and bear the character of a rational commercial decision. The presence of the latter characteristic does not determine the answer to the question whether, within the meaning of Part IVA, a person entered into or carried out a 'scheme' for the 'dominant purpose' of enabling the taxpayer to obtain a tax benefit.

...

Much turns upon the identification, among various purposes, of that which is 'dominant'. In its ordinary meaning, dominant indicates that purpose which was the ruling, prevailing, or most influential purpose. In the present case, if the taxpayer took steps which maximised their after-tax return and they did so in a manner indicating the presence of the 'dominant purpose' to obtain a 'tax benefit', then the criteria which were to be met before the Commissioner might make determinations under s177F were satisfied.<sup>17</sup>

94. 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.<sup>18</sup>

<sup>16</sup> See *FC of T v. Hart* (2004) 217 CLR 216 at 232; 2004 ATC 4599 at 4607; (2004) 55 ATR 712 at 721-2, per Gummow and Hayne JJ.

<sup>17</sup> 34 ATR 183 at 188; 96 ATC 5201 at 5206.

<sup>18</sup> *FC of T v. Peabody* (1994) 28 ATR 344 at 352; 94 ACT 4663 at 4670.



95. 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 the objective factors outlined in paragraph 177D(b) of the ITAA 1936. 'While it is unnecessary for the court to consider individually each of these matters, some of which may point in the one direction and others in the other direction, and it could consider them globally, it is useful here to consider these factors individually': see paragraph 82 of *Macquarie Finance*.<sup>19</sup> In evaluating the criteria in paragraph 177D(b), particular regard needs to be had to the following matters:

- (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. Similarly, an arrangement under which the lessee obtains no immediate funds at all, say, because the vendor lessee has no access to the price paid, is still more artificial.<sup>20</sup>

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

The choice of a sale and leaseback arrangement in lieu of another kind of financing arrangement, where the main benefit to either party in so choosing appears to be the tax benefits, may weigh in favour of a dominant purpose being the obtaining of such benefits: see the High Court's reasoning in *Hart*.

Thus, the manner of the scheme may point in the direction of having the requisite dominant purpose where a company needing to borrow funds, instead enters into a sale and leaseback arrangement of specialised plant or equipment that is a fixture, where the lessor's benefit under the scheme is limited to the availability of deductions for decline in value, and no practical commercial value will be obtained in respect of the asset at termination of the lease, other than by selling the asset back to the lessee.

<sup>19</sup> (2004) 210 ALR 508; 2004 ATC 4866; (2004) 57 ATR 115.

<sup>20</sup> This type of arrangement is similar to that considered by the House of Lords pursuant to the English doctrine of fiscal nullity in *Barclays Mercantile Business Finance Ltd v. Mawson (Inspector of Taxes)* [2004] UKHL 51; [2005] 1 AC 684.

- (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 exhibit characteristics which clearly show a dominant purpose that excludes the operation of Part IVA of the ITAA 1936. In regard to dominant purpose, see also 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).

An additional step that is interposed in a scheme and appears to serve no purpose other than to assist one of the parties to obtain a tax benefit will be relevant to the consideration of both the form and substance of the scheme, and the manner in which the scheme was entered into or carried out. The case of *Pridecraft Pty Ltd v. Commissioner of Taxation* [2004] FCAFC 339; 213 ALR 450; 2005 ATC 4001; 58 ATR 210 demonstrates that an arrangement, while pursuing an underlying commercial objective, can attract Part IVA because an intermediate, unnecessary step is used solely to obtain a tax benefit – see the comments of Sackville J (with whom Ryan and Sundberg JJ agreed) at ALR at 473; ATC at 4020; ATR at 232. See also *Federal Commissioner of Taxation v. Consolidated Press Holdings and Ors; CPH Property Pty Ltd v. FCT* [2001] HCA 32; 47 ATR 229; 2001 ATC 4343.

- (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 assessable income arising from a balancing adjustment event (particularly where these losses would not be transferable) and the lessor is in a position to use deductions available as a consequence of its ownership of the asset.

The particular timing of the arrangement (for example, year end) and the duration of the scheme (for example, limited to the period during which the lessor obtains a tax benefit around which the scheme is structured) and the nature of the tax benefit (for example, where there are accelerated decline in value 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 by way of 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 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 assessable income amount arising from the balancing adjustment event, 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 any amount being included in assessable income under section 40-285 of the ITAA 1997, 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 particularly 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.

96. The factors listed above should not be viewed in isolation from the whole range of circumstances surrounding the arrangements, and do not of themselves provide a checklist for the application of Part IVA of the ITAA 1936.

97. The application of Part IVA of the ITAA 1936 to a sale and leaseback arrangement was considered in the cases of *Metal Manufactures* and *Eastern Nitrogen*, in which the Full Federal Court found that Part IVA did not apply to the arrangements entered into in those cases. The reasoning of Lee J, with which Sundberg J agreed, in *Eastern Nitrogen* was later applied by Hill J in the Full Federal Court decision of *Hart and anor v. Commissioner of Taxation* (2002) 196 ALR 636; (2002) 2002 ATC 4608; (2002) 50 ATR 369. Hill J cited the following extract from Lee J's decision:

... the facts do not show that the dominant purpose of the appellant in entering that transaction which provided for the sale and lease-back of assets of the appellant was to obtain a tax benefit. In applying s 177D it is important not to elide the question posed by Pt IVA, namely, what was the dominant purpose of a relevant party in entering the transaction (or scheme) with the inquiry, would the transaction (or scheme) have been entered into 'but for' the tax benefit? The dominant purpose of the appellant was to obtain funds on the best available terms for use in the conduct of the appellant's business. The fact that the arrangements entered into to provide the funds included outgoings deductible under the Act was incidental to the purpose, but not the dominant purpose, of the transaction.<sup>21</sup>

98. While Hill J, at the Full Federal Court, followed and applied this reasoning to the Part IVA question, his reasoning was later overturned by the High Court. The High Court in *Hart* (2004) 2004 ATC 4599; (2004) 55 ATR 712; (2004) 217 CLR 216 found that, on the facts in that case, Part IVA of the ITAA 1936 did apply. Gleeson CJ and McHugh J, in their joint judgment, acknowledged and agreed with the proposition put at the Full Federal Court by Hely J, who noted:

A particular course of action may be both tax driven, and bear the character of a rational commercial decision. The presence of the latter characteristic does not determine in favour of the taxpayer whether, within the meaning of Pt IVA, a person entered into or carried out a 'scheme' for the dominant purpose of enabling a taxpayer to obtain a tax benefit: *FCT v. Spotless Services Ltd* (1996) 186 CLR 404 at 416; 34 ATR 183 at 188; 96 ATC 5201 at 5206. But nor does the fact that a taxpayer adopted one of 2 or more alternative courses of action, being the one that produces a tax benefit, determine the answer to that question in favour of the Commissioner: *Metal Manufactures Ltd v. FCT* (1999) 43 ATR 375 at 427; 99 ATC 5229 at 5275 per Emmett J (on appeal (2001) 108 FCR 150; 46 ATR 497; 2001 ATC 4152); *Spotless* (above) at CLR 425; ATR 194; ATC 5211-12 per McHugh J; *Inland Revenue Comrs v. Brebner* [1967] 2 AC 18 at 30, per Lord Upjohn.<sup>22</sup>

<sup>21</sup> *Eastern Nitrogen* ATC 4164 at 4168; ATR 474 at 479.

<sup>22</sup> 2002 ATC 4608 at 4625; (2002) 50 ATR 369 at 388.

99. The High Court went on to note, however, that:

...a transaction may take such a form that there is a particular scheme in respect of which a conclusion of the kind described in s177D is required, even though the particular scheme also advances a wider commercial objective...<sup>23</sup>

100. Thus the High Court made it clear that the fact that a scheme achieves the commercial objective of obtaining funds on the best available terms for use in the conduct of a business will not, by itself, determine the Part IVA question. An arrangement may be selected because it has the best available terms, and those terms may be the best because they have some tax benefits. However, the key issue is to determine whether the dominant purpose in selecting that particular arrangement is the obtaining of a tax benefit. Gleeson CJ and McHugh J in *Hart* considered what is meant by the requirement that the purpose be 'dominant', and turned to the joint reasons of the High Court in *FCT v. Spotless Services Ltd*:

Much turns upon the identification, among various purposes, of that which is 'dominant'. In its ordinary meaning, dominant indicates that purpose which was the ruling, prevailing, or most influential purpose. In the present case, if the taxpayers took steps which maximised their after-tax return and they did so in a manner indicating the presence of the 'dominant purpose' to obtain a 'tax benefit', then the criteria which were to be met before the Commissioner might make determinations under s 177F were satisfied'.<sup>24</sup>

101. In many sale and leaseback arrangements, the Commissioner will not seek to apply Part IVA of the ITAA 1936 because the arrangement does not exhibit characteristics that indicate a dominant purpose of obtaining a tax benefit. The following provides an example of such an arrangement:

*Example: Company A, which operates a construction business, owns a crane, which it sells to Company B. The sale price represents the market value for the crane at the time of the sale and is immediately and fully under Company A's control once paid. Company A includes an amount in its assessable income as a result of the balancing adjustment event that arises from the sale.*

*Company B then grants a lease over the crane to Company A, so that Company A can continue to use the crane in its construction business. Company A claims deductions for the periodic lease payments. Company B returns the lease payments as assessable income, and claims deductions for the decline in value of the crane. The lease payments are at market rates for the hiring of this type of equipment.*

*At the end of the lease, Company B offers the crane for sale to the public at large, with the sale price being based on the market value of the crane at that time. The crane is of such a kind that there is a general market for it beyond Company A, even though Company A may, in practice, buy the crane back.*

<sup>23</sup> Per Gleeson CJ and McHugh J, ATC 4599 at 4604; ATR 712 at 718.

<sup>24</sup> *FCT v. Spotless Services Ltd* (1996) 186 CLR 404 at 416, 1996 ATC 5201 at 5206; (1996) 34 ATR 183.

102. In the absence of any additional relevant factors, the Commissioner would not seek to apply Part IVA of the ITAA 1936 in a sale and leaseback arrangement entered into on similar terms to that described above.

103. A sale and leaseback arrangement which exhibits characteristics similar to those set out below may amount to a scheme to which Part IVA applies:

*Mine Co operates a coal mining business and owns a number of heavy machines, including a dragline (a massive, mobile earthmoving machine used to expose coal seams in open-cast mining operations). Mine Co wishes to raise approximately \$40 million to fund new coal exploration activities. Mine Co approaches several banks and other financial institutions that offer it proposals ranging from a direct secured loan to various types of structured financing proposals.*

*One financier, Cash Co, offers to purchase the dragline from Mine Co for the required \$40 million and immediately lease it back to Mine Co so that it can continue to be used in Mine Co's business.*

*Valuations of the dragline reveal that its valuation to Mine Co, on the basis that it is assembled and operating as part of its business, is \$80 million. The cost to replace the dragline, due to the costs of transportation and assembly of new equipment, would be around \$100 million. If the dragline were to be sold separately to Mine Co's business, it would attract around \$30 million in the open market.*

*Mine Co sells the dragline to Cash Co for \$40 million. Cash Co then immediately grants Mine Co a 5 year lease over the dragline.*

*The lease terms provide that the residual value of the dragline at the end of the lease will be \$25 million. After 5 years, the adjustable value of the dragline to Cash Co will be approximately \$25 million.*

*Mine Co claims deductions for the periodic lease payments, which are calculated at an annual rate of \$3 million plus 4.5% of the reducing adjustable value of the dragline. The market interest rate for asset finance at the time is 6%.*

*Cash Co returns the lease payments as assessable income, and claims deductions for the decline in value of the dragline.*

*At the end of the lease, Cash Co sells the dragline back to Mine Co for \$25 million. The dragline is not offered for sale to the public. No balancing adjustment amount is included in Cash Co's assessable income.*

*It is established that, had Mine Co. not accepted Cash Co's sale and leaseback proposal, it most likely would have borrowed the \$40 million at 6.5% interest plus principal repayments and provided a floating charge over its assets including the dragline as security.*

104. This arrangement gives rise to tax benefits under paragraph 177C(1)(b) of the ITAA 1936 to both Cash Co and to Mine Co in that, but for the scheme, Cash Co would not be entitled to deductions for the decline in value of the dragline and Mine Co's deductions would be limited to the interest paid on the principal outstanding from time to time.

105. The application of Part IVA of the ITAA 1936 depends on a careful weighing of all the relevant circumstances of each case, and the relative weight that should be attached to each of those circumstances. However, arrangements of the type described above are considered likely to give rise to a scheme under section 177A of the ITAA 1936, the dominant purpose of which is to obtain a tax benefit. Without addressing each of the eight factors in paragraph 177D(b) of the ITAA 1936 separately, the factors that point strongly to the application of Part IVA in this example are the non-arm's length sale price, the non-arm's length residual value, the apparent linking of the residual value to the adjustable value to Cash Co, the structuring of the lease payments to equate with the predetermined residual value and the fact that the dragline is not offered for sale to the public but is sold back to Mine Co for the predetermined residual value.

### **Conclusion**

106. 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 of the ITAA 1936 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, assuming there is no contrivance involved in the relevant transactions, 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 any balancing adjustments under section 40-285 of the ITAA 1997), and where there is no question as to the arrangements having a different characterisation.

---

## Appendix 2 – Alternative views

---

### Alternative view on sale value

107. An alternative view which has been advanced is that there should be no requirement for the asset to be valued as at the termination or expiry of the lease separately from the business of the lessee. 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. Support for this may be found in the judgment of Lee J in *Eastern Nitrogen*.<sup>25</sup>

108. 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.

109. The Commissioner recognises that there are a number of possible valuation methodologies. However, in the interests of providing greater certainty to the business community the Commissioner has indicated what is considered to be the most appropriate methodology for arrangements properly characterised as sale and leaseback. The Commissioner recognises that in some circumstances, where a lessee wishes to continue to use an asset in a profitable business, the deprival value to that business may be realised by the lessor. The reason why a value separated from the business is considered to be the most appropriate is outlined above, at paragraph 50. The value of an asset to the lessor in the event of default by the lessee or termination of the lease, even if based upon the present value of future income expected to be generated by the asset, cannot reasonably be based on the income to be generated by the lessee's own continued use or under the lease where it is at least likely that continued use cannot be assumed. Arguably, this reasoning led to the view expressed by Drummond J in *Eastern Nitrogen*<sup>26</sup> that the amount paid by the lessor in that case exceeded the market value of the plant. Be that as it may, the presence of one of the factors listed in paragraph 37 of this Ruling is not by itself necessarily determinative of the Part IVA question, and the Commissioner accepts that cases whose only material features are in line with those in *Metal Manufactures* and *Eastern Nitrogen* will not be affected by Part IVA.

---

<sup>25</sup> 2001 ATC 4164 at 4167.

<sup>26</sup> 99 ATC 5163 at 5186.



**Appendix 3 – Detailed contents list**

110. The following is a detailed contents list for this Ruling:

|   | <b>Paragraph</b> |
|---|------------------|
| <b>What this Ruling is about</b>  | <b>1</b>         |
| Class of entities/scheme  | 3                |
| Effect of sale and leaseback arrangements   | 8                |
| <b>Ruling</b>   | <b>10</b>        |
| Usual tax treatment of sale and leasebacks  | 10               |
| <i>Balancing adjustments</i>  | 11               |
| <i>Deductions for decline in value</i>  | 12               |
| <i>Lease payments</i>   | 14               |
| <i>Proceeds of sale by lessor</i>   | 16               |
| <i>Alternative tax treatments</i>   | 18               |
| Sale value  | 21               |
| Circumstances where sale and leasebacks may have a different tax effect   | 24               |
| Where the asset is a fixture  | 25               |
| 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 | 34               |
| Sham transactions   | 35               |
| Part IVA  | 37               |
| <b>Date of effect</b>   | <b>43</b>        |
| <b>Previous Rulings</b>   | <b>44</b>        |
| <b>Appendix 1 – Explanation</b>   | <b>45</b>        |
| Usual tax treatment of sale and leasebacks  | 45               |
| Sale value  | 50               |
| Where the transactions have a different tax effect  | 54               |
| <i>Hire purchase</i>  | 55               |
| Fixtures  | 57               |
| Section 51AD  | 73               |
| Sham  | 76               |
| <i>Legal characterisation of the arrangement</i>  | 78               |
| Part IVA  | 84               |
| <i>Scheme</i>   | 85               |

|  |            |
|--|------------|
| <i>Tax benefit</i>                         | 88         |
| <i>Dominant purpose</i>                    | 92         |
| Conclusion                                 | 106        |
| <b>Appendix 2 – Alternative views</b>      | <b>107</b> |
| Alternative view on sale value             | 107        |
| <b>Appendix 3 – Detailed contents list</b> | <b>110</b> |

## References

*Previous draft:*

TR 2006/D5

*Related Rulings/Determinations:*

TR 96/22; TR 2005/20; IT 28;  
IT 196; IT 2051; IT 2162;  
IT 2166; IT 2220; IT 2594;  
TD 93/142

*Previous Rulings/Determinations:*

TR 95/30

*Subject references:*

- anti-avoidance
- balancing adjustment
- decline in value
- fixtures
- leasing
- sale and leaseback

*Legislative references:*

- ITAA 1936 51AD
- ITAA 1936 51AD(6)
- ITAA 1936 51AD(8)(a)
- ITAA 1936 51AD(10)
- ITAA 1936 54
- ITAA 1936 57AM(33)
- ITAA 1936 82AB(7)
- ITAA 1936 Pt III Div 16D
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177A(5)
- ITAA 1936 177C
- ITAA 1936 177C(1)
- ITAA 1936 177C(1)(b)
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1936 177F
- ITAA 1997 Div 40
- ITAA 1997 40-30
- ITAA 1997 40-35
- ITAA 1997 40-40
- ITAA 1997 40-50
- ITAA 1997 40-65(3)
- ITAA 1997 40-85
- ITAA 1997 40-95(5)
- ITAA 1997 40-95(5B)
- ITAA 1997 40-95(5C)
- ITAA 1997 40-180(2)
- ITAA 1997 40-220
- ITAA 1997 40-285
- ITAA 1997 40-285(1)

- ITAA 1997 40-285(2)
- ITAA 1997 40-295
- ITAA 1997 40-295(1)(b)
- ITAA 1997 40-300
- ITAA 1997 40-305
- ITAA 1997 Subdiv 40-F
- ITAA 1997 Subdiv 40-G
- ITAA 1997 Div 43
- ITAA 1997 Div 240
- ITAA 1997 240-10
- ITAA 1997 240-15
- ITAA 1997 Div 328
- ITAA 1997 Div 775
- ITAA 1997 995-1
- ITAA 1997 995-1(1)
- TAA 1953

*Case references:*

- Ascot Investments Pty Ltd v. Harper and Harper (1981) 148 CLR 337
- Australia and New Zealand Savings Bank Ltd v. Commissioner of Taxation (1993) 42 FCR 535; 93 ATC 4370; (1993) 25 ATR 369
- Barclays Mercantile Business Finance Ltd v. Mawson (Inspector of Taxes) [2004] UKHL 51; [2005] 1 AC 684; [2005] 1 All ER 97
- Bellinz v. Commissioner of Taxation (Cth) (1998) 84 FCR 154; 98 ATC 4634; (1998) 39 ATR 198
- Bellinz Pty Ltd & Ors v. FC of T (1998) 39 ATR 198; 98 ATC 4634
- Commissioner of Taxation v. Morgan (1961) 106 CLR 517
- Eastern Nitrogen Ltd v. Commissioner of Taxation (2001) 108 FCR 27; 2001 ATC 4164; (2001) 46 ATR 474
- FC of T v. Ballarat & Western Victoria TV Limited 78 ATC 4630; 9 ATR 274
- FC of T v. Citibank Ltd and Ors (1993) 26 ATR 423; 93 ATC 4691
- FC of T v. Consolidated Press Holdings and Ors; CPH Property Pty Ltd v. FC of T [2001] HCA 32; 47 ATR 229; 2001 ATC 4343

- FC of T v. Hart (2004) 217 CLR 216; 2004 ATC 4599; (2004) 55 ATR 712
  - FC of T v. Metal Manufactures Ltd (2001) 108 FCR 150; 2001 ATC 4152; (2001) 46 ATR 497
  - FC of T v. Myer Emporium Ltd (1987) 163 CLR 199; (1987) 87 ATC 4363; (1987) 18 ATR 693
  - FC of T v. Peabody (1994) 28 ATR 344; 94 ATC 4663
  - FC of T v. Spotless Services Ltd (1996) 186 CLR 404; (1996) 96 ATC 5201; (1996) 34 ATR 183
  - FC of T v. Whitfords Beach Pty Ltd (1982) 12 ATR 692; 82 ATC 4031; 150 CLR 355
  - Gould and Gould; Swire Investments Ltd [1993] FLC 92-434
  - Hart and anor v. Commissioner of Taxation (2002) 196 ALR 636; 2002 ATC 4608; (2002) 50 ATR 369
  - Inland Revenue Comrs v. Brebner [1967] 2 AC 18
  - Macquarie Finance Ltd v. FC of T (2004) 210 ALR 508; 2004 ATC 4866; (2004) 57 ATR 115
  - Melluish (Inspector of Taxes) v. BMI (No. 3) Ltd [1996] AC 454
  - Metal Manufactures Ltd v. FCT (1999) 43 ATR 375; 427; 99 ATC 5229
  - Mills v. Stokman (1966) 116 CLR 61
  - Peabody v. FC of T (1992) 24 ATR 58; 92 ATC 4585
  - Pridecraft Pty Ltd v. Commissioner of Taxation [2004] FCAFC 339; 213 ALR 450; 2005 ATC 4001; 58 ATR 210
  - Scott v. Commissioner of Taxation (No. 2) (1966) 14 ATD 333; 40 ALJR 265
  - Sharment Pty Ltd & Ors v. Official Trustee in Bankruptcy (1988) 82 ALR 530
  - Snook v. London and West Riding Investments Ltd [1967] 1 All ER 518; [1967] 2 QB 786
- Other references:*
- Law Administration Practice Statement PS LA 2005/24

**ATO references**

- NO: 2005/13750  
 ISSN: 1039-0731  
 ATOLaw topic: Income Tax ~ Capital allowances ~ balancing adjustments - balancing adjustment amount  
 Income Tax ~ Capital allowances ~ balancing adjustments - balancing adjustment event  
 Income Tax ~ Capital allowances ~ holder of a depreciating asset  
 Income Tax ~ Capital allowances ~ cost of depreciating assets  
 Income Tax ~ Deductions ~ lease expenses  
 Income Tax ~ Project financing ~ hire purchase agreements  
 Income Tax ~ Project financing ~ leasing arrangements  
 Income Tax ~ Tax integrity measures ~ schemes