IT 2169 - Income tax: equity leasing transactions

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TAXATION RULING NO. IT 2169

INCOME TAX: EQUITY LEASING TRANSACTIONS

F.O.I. EMBARGO: May be released

REF
H.O. REF: 84/6430-8 DATE OF EFFECT: Immediate

B.O. REF: DATE ORIG. MEMO ISSUED:

F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1187194	LEASING TRANSACTIONS	
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OTHER RULINGS ON TOPIC IT 2051

PREAMBLE

Taxation Ruling No. IT 2051 of 29 July 1983 sets out the minimum standards with which leveraged lease transactions must comply if they are to be acceptable for income tax purposes.

2. Since the issue of IT 2051 it has become apparent that a variety of lease transactions have been concluded which differ from a leveraged lease in one material respect only. In its usual form a leveraged lease involves as a central distinctive feature the use of substantial borrowings for which legal recourse against the lessor partners is specifically precluded in the event of default. The lease transactions which are the subject of the Ruling do not embody this feature - debt funds contributed to the transaction are fully recoverable from the lessors should a lessee fail to meet the lease obligations. These transactions are commonly termed "equity" leases.

RULING

3. Notwithstanding that the guidelines in IT 2051 were formulated specifically to apply to leveraged leases it is clear that, with some modification, they apply with equal force to equity leases. The fully recourse nature of debt funding does not constitute a valid basis of differentiation. Subject to the following modifications equity lease transactions entered into henceforth will be expected to observe the general requirements of IT 2051.

4. The first modification concerns the debt/equity ratio requirement set out in IT 2051, paragraph 10. In an equity lease where a lessor partner draws from its general pool of funds to finance its participation in a particular transaction this requirement can have no application.

5. Additionally, the fully recourse nature of an equity lease requires modification of another of the broad requirements of IT 2051. At paragraph 4 of IT 2051 it is stated that, in a leverage lease transaction the aggregate profits of a partnership will generally equal and sometimes exceed aggregate losses over the entire period of the lease, the impact of any investment allowance deductions aside. In the context of an equity lease in which outgoings by way of interest or other financing costs e.g., discounts, are not borne by the partnership but rather by the individual partners, it is not possible to properly evaluate a lease transaction as is required by IT 2051, paragraph 6, if the cost of funds contributed to the transaction is disregarded. Consequently, in addition to the cash flow and tax projections for an equity lease partnership which are required for assessing purposes, each partner would need to provide full details of funds contributed to the lease partnership and of the associated costs.

6. A final observation is warranted. Whether the precise requirements expressed in IT 2051 and this Ruling will apply to other financial transactions similar to leveraged and equity leases can only be determined after examination of the particular transaction. Nevertheless, the guidelines set out in IT 2051 and this Ruling express general principles of income tax law and it is expected that they will be followed.

7. It is understood that lease transactions broadly comparable to those under consideration in this Ruling and in IT 2051 but involving buildings rather than plant and equipment are currently being concluded. Until this Office has had an opportunity to consider the particular financing arrangements there can be no certainly as to the precise tax consequences.

COMMISSIONER OF TAXATION
28 June 1985