


IT 2557 - Income tax : assessability or deductibility of an amount in respect of accrued leave entitlement taken into account in the purchase price of a business

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 This ruling contains references to repealed provisions, some of which may have been rewritten. The ruling still has effect. Paragraph 32 in TR 2006/10 provides further guidance on the status and binding effect of public rulings where the law has been repealed or repealed and rewritten. The legislative references at the end of the ruling indicate the repealed provisions and, where applicable, the rewritten provisions.

TAXATION RULING NO. IT 2557

INCOME TAX : ASSESSABILITY OR DEDUCTIBILITY OF AN
AMOUNT IN RESPECT OF ACCRUED LEAVE ENTITLEMENT TAKEN
INTO ACCOUNT IN THE PURCHASE PRICE OF A BUSINESS

F.O.I. EMBARGO: May be released

REF N.O. REF: 87/1172-1 DATE OF EFFECT: Immediate

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

F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1011541	ACCRUED LEAVE ENTITLEMENT	25(1)
	PURCHASE OF A BUSINESS	26(j)
	ASSESSABLE INCOME	51(1)
	ALLOWABLE DEDUCTIONS	51(3)

PREAMBLE This ruling is issued in consequence of the decision of the Federal Court of Australia reported as TNT Skypak International (Aust.) Pty. Ltd. v. FCT 88 ATC 4279 ; 19 ATR 1067 in which Gummow J. allowed the taxpayer's appeal from a decision of the Administrative Appeals Tribunal reported as Case U9 87 ATC 138; Tribunal Case 19 18 ATR 3099.

2. The issue before the Tribunal and on which the taxpayer sought to appeal to the Federal Court concerned whether an amount in respect of accrued annual leave entitlement set off against the purchase price of a business could constitute assessable income in the hands of a purchaser of the business.

FACTS 3. The taxpayer company purchased part of the business of another company. The purchase price under the agreement was to be calculated by reference to the net assets of the business, that is after taking into account assumed liabilities. One of the liabilities taken into account in the calculation was an amount of \$95,200 in respect of accrued annual leave entitlement owing to employees.

4. Under the agreement the taxpayer company had covenanted, amongst other things, to assume the liability to pay the leave entitlement to the employees as required.

5. In raising the assessment the amount of \$95,200 was included as income under subsection 25(1) and/or paragraph 26(j) of the Income Tax Assessment Act ("the Act"). The Tribunal in the first instance agreed with this treatment and upheld the assessment

6. The Federal Court overturned the decision of the Tribunal. It held that the amount of \$95,200 was not assessable income to the taxpayer under either subsection 25(1) or paragraph 26(j) because no amount had been received by the taxpayer. All that had occurred was that the taxpayer had assumed a liability in

respect of leave entitlements which had, or would, become due. The assumption of such a liability, said the Federal Court, does not ordinarily constitute the derivation of income.

7. The Court rejected the Commissioner's submission that there had been an amount received by virtue of the set-off of cross debts. It found that there were no cross debts between the parties and that the only debt was the debt owed under the purchase agreement by the taxpayer.

RULING

8. In view of the decision of the Federal Court it is accepted that where an amount in respect of accrued leave entitlement is taken into consideration in the valuation of the purchase price of a business (so that the purchaser receives the advantage of a reduction in the purchase price), there is no derivation of income by the purchaser. In these circumstances, the purchase price simply reflects the value of the business assets net of liabilities and there would be no payment or setting-off of cross debts relating specifically to the liability for accrued leave entitlement.

9. On the other side of the coin, the amount of any provision made in the purchase price of a business in respect of accrued leave entitlement will not be deductible to the vendor. This is due to the fact that subsection 51(3) will only allow a deduction in respect of long service leave, annual, sick or other paid leave where the leave payment is made to the person entitled to take the leave, not to a purchaser who is simply assuming liability for making future leave payments.

10. Accordingly where an arrangement is entered into such that the purchaser of a business assumes liability for making payments in respect of accrued leave entitlements to employees, the purchaser will be entitled to claim a deduction in respect of those payments at the time the payment is made to the employee.

COMMISSIONER OF TAXATION
24 August 1989