

REINFORCING TAX SYSTEM INTEGRITY — ADDRESSING THE TAXATION OF LEASE ASSIGNMENTS

The Government will amend the law by legislating to ensure that the full consideration received from assigning leases is taxed.

Key features

The measure will include in assessable income the full consideration received on disposing of interests in leased plant or leases. The measure will also apply to disposals of majority interests in 100 per cent owned subsidiaries that are used to lease assets — because lease assignments can also be achieved by selling the entity that holds the leased asset. Further details are provided in the appendix to this attachment.

Commencement

Application from 22 February 1999, as foreshadowed in the Treasurer's Press Release No 10 of 22 February 1999 and the accompanying letter from Mr Ralph to the Treasurer.

Current arrangements

The current law allows tax which should be payable in the later part of leases to be avoided through assigning interests in leases to tax exempt or low tax entities, after significant deductions have been taken in the early part of the lease. This tax is avoided either by taking advantage of a balancing charge rollover rule which applies when there is a partial change in ownership (such as a change in partnership interests) or by effectively transferring associated debt along with the lease.

Why change is needed

This integrity measure is needed to address tax avoidance opportunities that were highlighted in the Review of Business Taxation discussion paper *A Platform for Consultation* released on 22 February 1999.

Addressing the Taxation of Lease Assignments — Further Detail

Lease assignments are arrangements whereby tax that would be payable in the later part of a lease of depreciable plant is avoided, either by disposing of interests in the leased plant (together with the lease) or by disposing of interests in the lease without disposing of the plant itself.

How lease assignments operate

Under the current law, tax can be avoided through assigning interests in leases to tax exempt or low tax entities by taking advantage of a balancing charge rollover rule which applies where there is a partial change in ownership of the leased asset, or by effectively transferring debt along with interests in the lease asset or the lease. Lease assignments can also be undertaken by disposing of interests in a 100 per cent subsidiary that owns the leased asset.

In all these cases, the effect of the lease assignment is that little or no tax is paid in the later part of leases, either by the assignor or by the tax exempt or low tax rate assignee. In contrast, significant levels of deductions have been taken by the assignor in the early part of the lease, in the form of accelerated depreciation allowances and interest deductions.

Lease assignments typically take place when accelerated capital allowances have been substantially exhausted, and the lease would normally enter its 'tax positive phase'. By disposing of (typically) a 99 per cent interest in the leased plant at this point, the lessor can avoid a balancing charge through taking advantage of a rollover provision that would not apply if 100 per cent of the leased asset were disposed of. Alternatively, the lessor may effectively transfer debt to the assignee along with the interest in the leased asset or lease for a nominal sum. The assignee assumes responsibility to repay the debt. The assignor is no longer liable for tax on the lease income and is not taxed on the benefit received through being relieved the debt.

The need to address lease assignments foreshadowed

A Tax System Redesigned (Recommendation 10.13) recommended that lease assignments be appropriately taxed. In his press release of 22 February 1999, the Treasurer gave notice that the Government reserved the right to take such action as was necessary to address any deficiencies in the current tax system in the period between the release of *A Platform for Consultation* and when new legislation on a new business system was enacted. Lease assignments were specifically cited in Mr John Ralph's letter of 22 February to the Treasurer, which accompanied the press release.

Transactions to be covered by the measure

The legislation will address lease assignments undertaken on or after 22 February 1999. Under the legislation, the full consideration received on disposing of an interest in leased plant or a lease on or after 22 February 1999 will be brought to account where:

- the plant was a leased asset at or after 22 February 1999;
- the plant has been used primarily for leasing to others by the lessor or an associate; and
- the lessor or an associate has deducted amounts for depreciation.

How the legislation will operate

The legislation will have the following effect:

- Where a disposal of leased plant (or a partial disposal of an ownership interest in leased plant) constitutes a balancing adjustment event, the lessor's assessable income will include any excess over the plant's written down value of the money consideration and other benefits obtained from the disposal, up to a maximum of the depreciation deductions allowed or allowable for the plant.
- If the lessor disposes of an interest in the lease without disposing of the plant itself, the lessor's assessable income will include the money consideration for the disposal plus the value of other benefits obtained as a result of the disposal.
- Similar consequences will follow to those outlined in the two previous instances if a partner in a partnership disposes:
 - of an interest in a partnership so as to reduce the partner's interest in plant which the partnership has used to lease to other entities; or
 - of a right or interest in a lease.
- If an interest in leased plant is effectively disposed of by disposing of a majority interest in a wholly owned leasing subsidiary, the leasing subsidiary will be treated as having disposed of the leased plant and re-acquired it at market value. No balancing charge offset will apply. This will bring to tax any excess of the leased plant's market value over its written down value at the time of the 'deemed disposal'.
 - This adjustment will not occur where the main business of the new owners of the leasing subsidiary is the same as the main business of the former group.
 - Where this adjustment takes place, the companies that were in the same group as the de-grouped subsidiary will become jointly and severally liable with the subsidiary for the tax attributable to the deemed disposal transaction if the former subsidiary does not pay the tax within six months of it becoming payable. This rule is necessary to ensure that the subsidiary will be able to meet its tax obligations.
- Where more than 50 per cent of the shares of a wholly owned subsidiary which is a partner in a leasing partnership change hands, the subsidiary will be treated as having disposed of its interest in plant that has been used by the partnership to lease to other entities. The de-grouped subsidiary will become liable to tax on the difference between the market value of its interest in the leased plant and the proportion of its written down value attributable to that interest.
 - Again this rule will not apply where the main business of the new owners of the subsidiary is the same as the main business of the former group.
- Where leased plant that was formerly owned by a tax-exempt entity is partially disposed of by a taxpayer to a tax advantaged entity, and if the full disposal of the plant would have given rise to an adjustment under Division 58 of the *Income Tax Assessment Act 1997*, then the taxpayer will be subject to a similar adjustment on a proportionate basis.