Leasing of Machinery and Plant – Scenarios where Section 299(1) Applies

Part 09-02-08

This document should be read in conjunction with sections 288, 298, 299, 555 and 603 of the Taxes Consolidation Act 1997 and TDM Part 04-06-04.

Document created December 2024

Revenue
Cáin agus Custaim na hÉireann
Irish Tax and Customs

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Executive Summary/Introduction

As set out in TDM Part 04-06-04, the leasing of machinery or plant is, in law, a rental activity where the lessor retains ownership of the asset. As ownership of the leased asset remains with the lessor, they generally remain entitled to claim capital allowances on the leased asset.

However, in scenarios where:

- an asset is let on such terms that the lessee is bound to maintain the machinery or plant and deliver it over in good condition at the end of the lease, and
- the burden of the wear and tear of the machinery or plant in fact falls directly on that person

section 299(1) provides that the entitlement to claim capital allowances will generally fall to the lessee instead.

In scenarios where the entitlement to capital allowances falls to the lessee, the transaction is more likely to be substantively similar to a financing transaction. In this regard section 299 was amended by Finance (No.2) Act 2023 to allow the lessor to calculate taxable profits from qualifying leases ('relevant leases') using computational principles more consistent with that of a financing transaction where section 299(1) applies, subject to certain criteria being met.

This manual sets out the tax implications for leases within the meaning of section 299(1).

1 Application of Section 299

Section 299(1) provides that a lessee may claim wear and tear allowances on leased machinery and plant where the lessee is carrying out their activities in the course of a trade and the asset—

a) is the subject of a "relevant lease", and
b) is let such that the lessee is "bound to maintain the machinery or plant and deliver it over in good condition at the end of the lease" and "the burden of the wear and tear of the machinery or plant in fact falls directly on [them]".

Where section 299(1) applies in respect of a relevant lease:

- the lessee is deemed to have incurred the capital expenditure on the leased asset, and
- the leased asset is deemed to belong only to the lessee, irrespective of who holds title to the asset.

For ease of reference, such a lease will be referred to in this TDM as a "section 299 lease".

1.1 Meaning of Relevant Lease [subsection (1A)]

A relevant lease is defined in subsection (1A) and refers to any lease with hallmarks of a financing transaction i.e.

a) any finance lease, or
b) any operating lease where:
    a) the present value of the minimum lease payments[1] is greater than or equal to 80% of the fair value of the asset,
    b) the term of the lease is more than 65 per cent of the remaining useful economic life of the asset, and
    c) the asset is subject to a purchase option that is likely to be exercised.

Whether a lease is a finance lease or an operating lease for the purposes of this section is dependent on how it falls to be treated under Generally Accepted Accounting Practice in Ireland (being IFRS or FRS).

1.2 Qualifying Lease Criteria [subsection (1)]

In order for a lessee to claim capital allowances on leased machinery or plant, the lessee must be "bound to maintain the machinery or plant and deliver it over in good condition at the end of the lease" and "the burden of the wear and tear of the machinery or plant in fact falls directly on [them]".

To understand this requirement, particularly with regard to the application of what is commonly referred to as the "burden of wear and tear" proviso in this context, the following UK cases, and how they build upon one another is relevant:

[1] This should be calculated using the interest rate implicit in the lease. Where a lessee does not know the implicit rate, they may use their incremental borrowing rate instead – the incremental borrowing rate option is available to lessees only.

a) Union Cold Storage Co, Ltd v Simpson (H M Inspector of Taxes); (2) Union Cold Storage Co, Ltd v Ellerker (H M Inspector of Taxes) (1939) 22 TC 547 ("Union Cold Storage")
b) Macsaga Investment Co Ltd v Lupton (H M Inspector of Taxes) (1967) 44 TC 659 ("Macsaga")
c) Lupton v Cadogan Gardens Developments Ltd (1971) 47 TC 1 ("Cadogan")

These cases considered the entitlement to wear and tear allowances for machinery and plant for both lessors and lessees.

2 Computation of Relevant Lease Profits and Expenses using Finance Lease Accounting Principles

The lessor and the lessee may both be able to use the principles set out in section 299 rather than section 76D to compute their leasing profits and costs where they have entered into a section 299 lease.

2.1 Application to Lessees

2.1.1 Computation of Relevant Lease Costs and Capital Allowances

The taxable profits of the lessee, in respect of a section 299 lease, are calculated in accordance with section 299(3)(c).

Under section 299(3)(c)(i), the amount of the lease costs that may be deducted by a lessee in a chargeable period is limited to the lease payments which have been deducted in the profit and loss account for the period in accordance with generally accepted accounting practice (typically the amount recorded as a financing cost amount for the lessee).

Under section 299(3)(c)(ii), there is a restriction on the capital expenditure upon which wear and tear allowances will be available for the lessee. For each section 299 lease, the restriction is that the amount on which allowances are available to the lessee is the lower of:

- the capital expenditure deemed to be incurred by the lessee by reason of section 299(1), and
- the difference between the total lease payments and the financing cost amount.

2.2 Application to Lessors

2.2.1 Computation of Relevant Lease Profits and Capital Allowances

Where the qualifying criteria set out in section 2.2.2 have been met by a corporate lessor in respect of a section 299 lease, the taxable profits in a chargeable period for the relevant lease may be calculated in accordance with section 299(4). This allows lessors to apply, for tax purposes, the computational rules for financing lessors set out in generally accepted accounting practice[2].

As set out in section 1, where section 299(1) applies, the lessee is deemed to have incurred the capital expenditure on the leased asset and the leased asset is deemed

to belong only to the lessee. As such, the entitlement to capital allowances rests with the lessee where section 299(1) applies, irrespective of whether section 299(4) applies.

2.2.2 Qualifying Criteria for Lessors

The qualifying criteria for lessors are set out in section 299(5). A lessor in a section 299 lease may calculate their profits using finance lease accounting principles where **all** of the following apply:

1. the lessor is a corporate lessor,
2. the leased asset actually belongs to the lessor (both immediately prior to the lease transaction (see section 2.2.2.1 for clarification on how this phrase should be read) and throughout the lease term),
3. the asset was acquired by the lessor by way of either:
   - a bargain at arm's length, or
   - a section 312(5) transfer (subject to the transferor of the asset having acquired the asset by way of a bargain at arm's length),
4. the asset was not subject to section 290 replacement asset relief,
5. the asset is leased on arm's length terms, and
6. the anti-double dip rules (see section 2.2.2.2) have not been triggered.

In addition to the above, a lessor can only calculate their profits under section 299, where the required disclosures have been made and the appropriate joint elections / agreements are in place:

- Where the lessee is an individual the lessor and lessee must jointly elect for this section to apply.
- Where the lessee is not an individual, the lessor and lessee must instead jointly agree at the outset where the burden of wear and tear lies.

2.2.2.1 Meaning of the Period Immediately Prior to Entering Lease

Section 299 recognises that scenarios can arise where a lease is entered into prior to the asset being in the possession of the lessor, e.g. in scenarios where a brand-new aircraft is to be leased out under finance lease, the lease may be agreed and signed before the manufacture of new aircraft is completed.

As such, in scenarios where a relevant lease of machinery or plant is entered into before the machinery or plant can be made available to the lessee, subsection (5B) provides that the belonging to requirement can be met on the date the machinery or plant is made available to the lessee, subject to no capital allowance tax advantage arising as a result of the change of date.

[2] This term is defined in section 4 of the Taxes Consolidation Act 1997 and refers to IFRS or FRS accounting rules only.

2.2.2.2 Anti-Avoidance - Anti-Double-Dip rules

Subsection (5A) contains anti-double-dip rules for section 299 leases. These rules prevent the section 299(4) computational rules from being misused to structure financing leases in a manner that would generate excess relief for lease payments. There is the general rule, in paragraph (b), and the associated company rule, in paragraph (a).

General Rule (paragraph (b))

Section 299(4) computational rules are not available to a lessor where it is **reasonable to consider** that:

1. the lease transaction has not been entered into for bona fide commercial reasons, or
2. the lease forms part of an arrangement under which a tax advantage arises, and,
    a) the tax advantage is priced into the terms of the arrangement, or
    b) the arrangement was designed to give rise to a tax advantage.

A tax advantage arises under an arrangement where, in respect of[3] the lease payments or the value of the leased machinery or plant, the total of the amounts of relief, deduction or allowance available (whether directly or indirectly) in computing Irish or foreign taxes, materially exceeds the total lease payments.

When testing a leasing arrangement against the anti-double dipping rules, the test refers to the amounts materially exceeding the total lease payments. This is because it is recognised that there are scenarios where tax rules or accounting standards in use in other countries may not fully align with the Irish rules, resulting in scenarios where the value of any capital allowance or depreciation granted, for example, may differ slightly from the value of the total lease payments.

Associated Company Rule (paragraph (a))

Where a lessor and lessee are associated enterprises[4] there is greater opportunity to structure a cross-border lease such that it would give rise to excessive tax reliefs in relation to the lease payments.

As such, the anti-double dip rules have been strengthened in the case of cross-border leases between associated lessors and lessees. For leases between associates, in addition to the protections in the general rule, the lessor cannot use the section 299(4) computational rules where at the commencement of the lease term:

- the lessee is entitled, in computing their foreign taxable profits to both:
    a) a relief for machinery and plant which corresponds to allowances available under Part 9 of the TCA (i.e. capital allowances or something approximating capital relief for the asset such as tax depreciation), and

[3] The Courts have found that 'in respect of' is given a very wide meaning. Refer to paragraph 13 of Kelly v An Bord Pleanála & Ors [2024] IEHC 468 for a summary of Irish jurisprudence on this issue.
[4] Refer to section 7 of TDM Part 35C-00-01 for guidance on associated enterprises.

b) any other deduction, allowance or relief in respect of the lease payments,

and

- it is reasonable to consider that the aggregate amount of any relief that is akin to capital allowances available to the lessee over the lease term materially exceeds the difference between the lease payments and any deduction, allowance or relief in respect of the lease payments.

Where the associated company rule applies to leased machinery or plant which is sublet by the lessee, the associated company rule applies in the same way to the sub-lessor and sub-lessee also.

If the terms of a cross-border lease between associates are amended during the lease term, the lessor is required to check if the associated company rule applies at the date the change of terms becomes effective.

3 Capital Implications Arising from Section 299

3.1 Interaction of section 299 and section 539

Section 539[5] outlines the circumstances in which hire purchase (or similar) transactions can give rise to a disposal for the purposes of Capital Gains Tax ("CGT"). The section provides that where:

- a transaction provides a person with the use and enjoyment of an asset for a period, and
- the asset will or may pass to such person at the end of the period,

then that asset will be treated for CGT purposes as an outright capital disposal at the beginning of the period of hire. If the hire transaction terminates without ownership of the asset actually passing to the hirer, the tax position is adjusted to reflect that no CGT disposal ever took place in the first instance.

Section 299(10) modifies the application of section 539 with regard to the leasing of machinery and plant. The leasing of machinery or plant is now only treated as an up-front disposal for CGT purposes where the transaction is also recognised and treated as a financing transaction for corporation tax purposes (i.e. where it is a section 299 lease in respect of which a valid claim or election has been made with regard to the tax treatment of the section).

3.2 Section 288 - Balancing Allowances and Balancing Charges

Section 288(1A) confirms that balancing events arise from the following two transfers of the entitlement to claim capital allowances to the lessee being:

1) In the hands of the lessor, the entering into[6] a section 299 lease (as section 299(1) transfers the belonging of the asset from the lessor to the lessee)[7], and
2) In the hands of the lessee, the reversion of an asset to the lessor at the conclusion of a section 299 lease (as section 299(1) reverts the belonging of the asset to the lessor).

For the purposes of calculating the balancing allowance and/or charge arising, section 288(6B) deems the sales proceeds to be:

- Where the lessor enters into a section 299 lease: the higher of:
    - the open-market price of the machinery or plant, and
    - the discounted present value of the lease payments under the lease.

[5] Refer to Tax and Duty Manual Part 19-01-10 for further information on section 539.
[6] In line with section 299(5B), the date a lease is entered into can be read as the date on which the asset is made available to the lessee, subject to no capital allowance tax advantage arising.
[7] As the asset does not belong to the lessor while a section 299 lease is active, the exercise of any purchase option on the lease by the lessee during the relevant lease term will not give rise to any further balancing event for the lessor.

- Where the asset is reverted to the lessor at the end of the lease term: the higher of:
    - the open-market price of the machinery or plant, and
    - the amount payable, or expected to be payable, under a residual value guarantee in respect of the machinery or plant.

Following the reversion of a leased asset to a lessor at the end of a section 299 lease, if the asset is again employed by the lessor as plant, the lessor may be entitled to claim capital allowances on the open-market price of the asset.

3.3 Reversion of Relevant Lease

In scenarios where the use and enjoyment of an asset that was the subject of a section 299 lease has reverted to the lessor, a number of anomalies may arise by reason of the lessor having foregone their entitlement to capital allowances over the lease term. As such, specific provision is made to deal with the interaction of section 299 and other sections in the TCA.

3.3.1 Section 555 - Restriction of Losses by Reference to Capital Allowances and Renewals Allowances.

Section 555(4) requires a lessor disposing of a capital asset that was the subject of a section 299 lease to have regard to any allowances forgone by reason of entering into the lease (in addition to any other allowances that have been or may have been made in respect of that asset).

This prevents the creation of artificial capital losses on the disposal of plant and machinery assets previously subject to a section 299 lease.

3.3.2 Section 603 – Wasting Chattels

Section 603(5) ensures that a lessor cannot avail of the wasting chattel exemption on the entering into of a section 299 lease.