[Part 04-05-05] Taxation of certain short-term leases of plant and machinery

1. Introduction

Sections 76D and 80A TCA 1997 provide special rules for the taxation of income from the trade of leasing.

s.76D sets aside the general rule in s.76A that taxable profit is determined in accordance with accounting principles in the case of Finance Leases and provides that the lessor will be taxable on the full lease payments less expenses incurred in the leasing trade. Lessors may continue to claim capital allowances as provided for in Part 9 of the Act.

s.80A provides an alternative taxing mechanism for lessors of certain short-term assets. This alleviates the timing mismatch that may occur where lease payments are received over, say, 3 years but capital allowances are given over an 8 year period.

s.80A provides that a lessor may elect to have income from finance leases of short life assets taxed in accordance with accounting principles rather than under the rules set out in s.76D. From 1 January 2010 this treatment is also available for operating leases.

This instruction sets out the tax treatment applicable to finance leases and operating leases of assets used for the purposes of a trade or profession where the lessor has made an election to be taxed in accordance with s.80A.

[Part 04-06-04 deals with the tax treatment applicable to finance leases of assets used for the purposes of a trade or profession where the lessor has **not** made an election to be taxed in accordance with s.80A**]**

2. Finance Leases

A finance lease is a lease that transfers substantially all the risks and rewards of ownership of an asset to the lessee. Most finance leases operate for a primary period during which the lessee effectively pays for the asset and for a secondary period during which the lessee may continue to lease the asset for a nominal amount.

Payment under a finance lease may be in the form of recurring payments or other types of payment which arise in more complex leases such as lump sum payments made by the lessee at the end of the lease-term (balloon payments).

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s.80A allows a lessor company to claim, in respect of accounting periods commencing on or after the 4th February 2004, to have all such income computed for tax purposes under accounting rules rather than under tax rules. This will result in the "interest element" of lease payments being taxed but no capital allowances being available. It will not change the amount of tax paid but will allow a more even spread of the tax over the lease period.

A claim made under this section enables a lessor company to have all income from short-term assets leased under a finance lease computed under accounting rules rather than under tax rules. The claim must be made at the time by which a tax return is due for an accounting period and the treatment is then available from the start of that accounting period. All future such income is computed for tax purposes under accounting rules.

3. Operating Lease

An operating lease is a non finance lease.

In the case of operating leases, s.80A allows a lessor company to elect to claim accounting depreciation in place of capital allowances on short life assets.

Accounting periods commencing on or after 1 January 2010 and ending on or before 31 December 2014:

Finance Act 2010 extended the option to apply the accounting treatment in computing income from short term leases to include operating leases from 1 January 2010. For periods ending on or before 31 December 2014 the treatment applies only where there has been an increase in the total value of short life assets leased on an operating lease by a lessor group of companies when compared to total value of short life assets leased on an operating lease and owned by the group at the end of the accounting period preceding the accounting period for which the depreciation treatment is first claimed.

The following formula is used to determine the increase in the total value of assets leased (i.e the Group Limit) in respect of an accounting period:

$$A + (B \times (C - D) / C)$$

A is the total value of capital allowances claimed by all group companies in an accounting period of one year ending immediately before an accounting period commencing on or after the 1st January 2010. **A** is referred to as the "Threshold Amount" in s.80A.

B is the aggregate of the amounts of depreciation charged to the Profit and Loss accounts of all group companies in respect of short life leasing assets (specified assets) in respect of the accounting period.

C is the aggregate cost of specified assets owned by all group companies at the end of the accounting period.

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D is the lesser of the aggregate cost of specified assets owned by all group companies in an accounting period of one year ending immediately before the first accounting period for which an election is made under this section (the "Threshold Period") or **C**.

The effect of the formula is to set a limit on the value of the allowances that can be claimed under s.80A in respect of Operating Leases. The limit is the increase in the total value of short life assets leased by the group and owned at the end of the accounting period prior to the accounting period for which the treatment available under s.80A is first claimed.

s.80A also sets out the formula for allocating the group limit between the lessor companies in the group based on the share of the group's specified asset portfolio owned by each individual company. It provides that the amount of the "wear and tear" allowance to be made to the company for any accounting period cannot exceed an amount to be calculated by the following formula:

$$E \times F/G$$

Where-

E: is the group limit (as calculated above),

F: is the cost of "specified assets" owned by the company at the end of the accounting period, and

G: is the cost of "specified assets" owned by all group companies at the end of the accounting period.

Accounting periods ending on or after 1 January 2015:

Section 36 Finance Act 2014 removed the Threshold Amount as it caused a disparity of treatment between leasing operations that were established pre-2010 and post- 2010.

The removal of the threshold amount will result in tax deductions which have been postponed under the threshold system being released over phased basis as short life assets reach the end of their useful lives.

For accounting periods ending on or after January 2015 the amount of wear and tear allowance claimed on specified assets under s.80A is to be calculated by reference to the amounts of depreciation/impairment which has been charged, in the accounting period, to the Profit and Loss account in accordance with generally accepted accounting principles. Deductions that have been postponed in prior years under the threshold system will become available as balancing allowances under s.288 as each asset is disposed of.

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