

DETERMINATION > FINANCIAL ARRANGEMENTS > SPECIAL

# **Spreading of income and expenditure under an agreement for the sale and purchase of assets**

Issued: 24 April 2020

S63

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## Determination

This Determination may be cited as *Special Determination S63: Spreading of income and expenditure under an agreement for the sale and purchase of assets*.

### 1 Explanation (which does not form part of the determination)

1. The Vendor and the Purchaser entered into an agreement for the sale and purchase of assets and an interest in a joint venture (the Agreement) on 2 December 2019.
2. The Agreement provides for the consideration to be calculated quarterly and by reference to:
  - a fixed instalment amount; plus
  - an amount based on volume of outputs produced by the assets; plus
  - a share of revenue from the sale of products generated from, or use of, the assets; less
  - certain costs incurred in holding the assets and in deriving revenue.
3. The total consideration payable by the Purchaser and the duration of the Agreement are unknown, due to the uncertain nature of outputs produced by the assets and the unique nature of the Agreement.
4. An adjustment calculated by reference to net working capital and employee entitlements was required to be calculated and paid by the Vendor to the Purchaser or by the Purchaser to the Vendor soon after the completion date (the Adjustment).
5. This determination prescribes the method for spreading the payments made under the Agreement.

### 2 Reference

This determination is made under s 90AC(1)(bb) of the Tax Administration Act 1994.

### 3 Scope of determination

1. This determination applies to the Purchaser and the Vendor in relation to the Agreement. Under the Agreement the Purchaser acquired certain assets and an

interest in a joint venture (the Property) in consideration for a quarterly payment calculated by reference to:

- a fixed instalment amount; plus
  - an amount based on volume of outputs produced by the assets; plus
  - a share of revenue from the sale of products generated from, or use of, the assets; less
  - certain costs incurred in holding the assets and in deriving revenue.
2. The total consideration payable by the Purchaser and the duration of the Agreement are unknown, due to the uncertain nature of outputs produced by the assets and the unique nature of the Agreement. The Agreement can result in payments being made by the Vendor to the Purchaser.
  3. The Agreement also provided for the acquisition of other specific assets (which are not part of the Property referred to in para 3.1) by the Purchaser in exchange for a one-off Adjustment to be paid soon after the completion date.
  4. The Purchaser and the Vendor both use International Financial Reporting Standards (IFRSs) to prepare financial statements and to report for financial arrangements.
  5. Both parties must apply the method specified in this determination.

## 4 Principle

1. The Agreement is a “financial arrangement” under s EW 3 and is an “agreement for the sale and purchase of property or services” under s YA 1. The Agreement is not an “excepted financial arrangement” under s EW 5.
2. The Adjustment is an “excepted financial arrangement” under s EW 5(22). Any amount that is solely attributable to an excepted financial arrangement described in ss EW 5(17) to (25) that is part of a financial arrangement, is an amount that is taken into account under the financial arrangements rules (s EW 6(3)). This determination specifies that amounts payable in relation to the Adjustment do not need to be spread under the financial arrangements rules.
3. Section EW 15C(1) does not apply to the Agreement, because the financial arrangement is an agreement for the sale and purchase of property or services that is not a “foreign ASAP” (as defined in s YA 1). Accordingly, one of the methods in s EW 151(2) must be used to allocate an amount of income or expenditure to an

income year. A method that is available under s EW 151(2)(c) is a determination made by the Commissioner.

4. The parties have agreed a lowest price for the Property. This is the value of the Property for the purposes of s EW 32. The lowest price has been separated into:
  - a lowest price for the Property (the Property Lowest Price); and
  - a lowest price for the Adjustment (the Adjustment Lowest Price).
5. Under s EW 29, in the income year in which the final payment is due under the Agreement, each Party will be required to undertake a base price adjustment (BPA) calculation.

## 5 Interpretation

In this determination, unless the context otherwise requires:

- All legislative references in this determination are to the Income Tax Act 2007, unless otherwise stated.

## 6 Method

1. The Adjustment amounts do not need to be spread under the financial arrangements rules.
2. In each income year prior to the year in which a BPA is required, each Party is only required to recognise income under the Arrangement to the extent that:
  - the Party receives a net payment from the other Party in that income year;
  - the payment received by the Party is not the Adjustment; and
  - the cumulative net amount of all of the consideration received and paid by the Party in that income year and all preceding income years for the Property (excluding the Adjustment) exceeds the Property Lowest Price.
3. In each income year prior to the year in which a BPA is required, each Party may only recognise expenditure under the Arrangement to the extent that:
  - the Party makes a net payment to the other Party in that income year;
  - the payment made to the Party is not the Adjustment; and

- the cumulative net amount of all of the consideration paid and received by the Party in that income year and all preceding income years for the Property (excluding the Adjustment) exceeds the Property Lowest Price.
4. In the income year in which the final payment is due under the Agreement, each Party will be required to undertake a BPA calculation.

## 7 Example

The following examples illustrate the application of the method set out in this determination.

The figures and values used in these examples are indicative only and cannot be relied on as an indication of the expected cashflows under the Agreement.

### Example A

This example is based on the following:

- The Parties have agreed a Property Lowest Price of \$20 million;
- The Vendor receives \$2 million in year 1 for the Adjustment;
- The Vendor receives the following payments from the Purchaser for the Property:
  - \$8 million in year 1;
  - \$10 million in year 2;
  - \$10 million in year 3; and
  - \$6 million in year 4.
- The Agreement terminates in year 4.
- The Vendor does not make any payments to the Purchaser.

No part of the Adjustment needs to be spread under the financial arrangements rules.

In relation to the Property, the Vendor will recognise income and expenditure from the Agreement as follows (excluding the Adjustment):

	Year 1	Year 2	Year 3	Year 4
Cumulative cash received / (paid)	\$8 million	\$18 million	\$28 million	\$34 million

Income / (expenditure) recognised in income year	\$0	\$0	\$8 million	\$6 million  (Determined under the BPA)
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In relation to the Property, the Purchaser will recognise income and expenditure from the Agreement as follows:

	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>
Cumulative cash received / (paid)	(\$8 million)	(\$18 million)	(\$28 million)	(\$34 million)
Income / (expenditure) recognised in income year	\$0	\$0	(\$8 million)	(\$6 million)  (Determined under the BPA)

### **Example B**

This example is based on the following:

- The Parties have agreed a Property Lowest Price of \$20 million;
- The Vendor receives \$2 million in year 1 for the Adjustment;
- The Vendor has received the following payments from Purchaser for the Property:
  - \$15 million in year 1;
  - \$0 million in year 2;
  - \$8 million in year 3
  - \$4 million in year 4; and
  - \$6 million in year 5.
- The Purchaser receives a payment of \$5 million for the Property from the Vendor in year 2.
- The Agreement terminates in year 5.

No part of the Adjustment needs to be spread under the financial arrangements rules.

In relation to the Property, the Vendor will recognise income and expenditure from the Agreement as follows (excluding the Adjustment):

	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
Cumulative cash received / (paid)	\$15 million	\$10 million	\$18 million	\$22 million	\$28 million
Income / (expenditure) recognised in income year	\$0	\$0	\$0	\$2 million	\$6 million (Determined under the BPA)

In relation to the Property, the Purchaser will recognise income and expenditure from the Agreement as follows:

	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
Cumulative cash received / (paid)	(\$15 million)	(\$10 million)	(\$18 million)	(\$22 million)	(\$28 million)
Income / (expenditure) recognised in income year	\$0	\$0	\$0	(\$2 million)	(\$6 million) (Determined under the BPA)

This determination is signed by me on the 24<sup>th</sup> day of April 2020.

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**Howard Davis**

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## References

### Legislative references

Tax Administration Act 1994: s 90AC(1)(bb)

Income Tax Act 2007: subpart EW (financial arrangements rules)

## About this publication

### Financial arrangement determination - special

The Commissioner may determine certain matters relating to financial arrangements. A taxpayer may wish to apply for a determination to ascertain the tax treatment of a particular financial arrangement.