

JOINT SUBMISSION BY

**CPA Australia, The Institute of Chartered Accountants in Australia, the National
Institute of Accountants, the Taxation Institute of Australia
and Taxpayers Australia**

Draft Taxation Ruling TR 2009/D2

Income tax: trading stock – treatment of discounts, rebates and other trade incentives offered by sellers to buyers

Date: 19 June 2009

The Professional Bodies welcome the opportunity to provide the following comments on Draft Taxation Ruling TR 2009/D2 ('the Draft Ruling').

GENERAL COMMENTS

We are of the view that the tax treatment of discounts, rebates and other trade incentives on the purchase of trading stock by buyers and sellers set out in the Draft Ruling is acceptable. However, we are of the view that some of the analysis of the characterisation of the discounts, rebates and trade incentives to reach the resulting tax treatment is not technically correct. That is, it is not technically correct that just because an incentive is subject to a condition means the incentive is not directly related to the cost of acquiring the trading stock. However, in view of the tax law concepts of 'derivation' of the assessable income for the seller and outgoing 'incurred' for the purchaser, the timing recognition of the resultant assessable income and deduction for income tax in the Draft Ruling is appropriate.

SPECIFIC COMMENTS

We also recognise that paragraphs 5 and 6 of the Draft Ruling may provide a purchaser with a favourable timing advantage in some circumstances where a condition relating to the provision of the trade incentive is not satisfied at the time of purchase. In these circumstances the Draft Ruling proposes that the amount of the trade incentive will not reduce the deductible cost of the purchased trading stock but will be returned by the purchaser as assessable income in the income year in which it is earned – which may be a later income year than the one in which the purchase was made.

For example, in Example 2 a purchaser may obtain a favourable timing advantage if the rebate of \$32,000 applicable to the first 80,000 items purchased in the income year is not actually credited to the buyer's account until sometime in the following income year. That is, as paragraph 27 highlights, the "rebate of \$32,000 applicable to the first 80,000 items is derived as ordinary income of the buyer ... at the time when the seller credits the buyer's account with the \$32,000.

In advancing these views significant reliance is placed on Taxation Ruling TR96/20.

Whilst we recognise this is a favourable outcome we are concerned that there could be non-compliance by purchasers who may automatically offset the trade incentive against the cost of trading stock for accounting purposes when applying Australian Accounting Standard AASB 102.11 who then fail to make a tax only adjustment to recognise the above timing deferral in calculating taxable income.

This is especially relevant for purchasers who may regard the book and tax treatment of trading stock as being increasingly aligned following the issue of Taxation Ruling TR2006/8 which extended absorption costing accounting principles to the tax treatment of trading stock by wholesalers and retailers.

Moreover, the reliance on the views advanced in Taxation Ruling TR96/20 may not be appropriate as this ruling relied on the former accounting standards which did not require that the cost of trading stock be reduced by the incentives received, and which has now been superseded by Accounting Standard AASB 102.11 effective 1 July 2007.

Accordingly, one option for consideration may be to allow the purchaser to choose to either apply the tax treatment specified in the Draft Ruling in respect of 'conditional' trade incentives or to allow the purchaser to simply apply the book treatment stipulated in Australian Accounting Standard AASB 102.11 which would eliminate the need to make a tax only adjustment. The latter option may be attractive to a purchaser where the provision of such conditional trade incentives is not material but the taxpayer is seeking to minimise adjustments in calculating taxable income whilst being income tax compliant.

In addition, from a compliance burden perspective, it may be desirable to have an interface between income tax and GST issues otherwise management reporting could be problematic for taxpayers as they would need different systems to capture the different treatments under accounting, income tax and GST.

Finally, the analysis of discounts, rebates and trade incentives in determining whether there has been a change in consideration for a supply in GST Ruling GSTR2000/19 and the sales tax cases, *Queensland Independent Wholesalers Limited v Commissioner of Taxation* 91991) 29 FCR 312 and *Colgate-Palmolive Pty Ltd v Commissioner of Taxation* 99ATC 4289 lends support to the view that just because an incentive is subject to a condition does not mean that the incentive is not directly related to the cost of acquiring the trading stock. Ultimately, whether there is a change in the cost of trading stock will depend on the circumstances. It is the substance of the arrangement giving rise to the discount/rebate/trade incentive that should determine whether it should be characterised as a reduction in the cost of trading stock or otherwise.