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Buy-back commitment in motor trade to be taken up as separate item

The finance ministry has decreed that a motor vehicle dealer who has undertaken to buy back a vehicle from a customer must take up the option premium as a liability to be released on expiry of the option.

In November 2010, the Supreme Tax Court held that a motor car dealer who had promised his customer to buy back on demand a vehicle at an agreed price by an agreed date had effectively granted the customer a put option. The dealer should take up the option premium as a liability to be carried forward until the option was exercised or expired. The finance ministry has issued a decree accepting the case as a precedent and requiring reciprocal treatment by the customer. Under the decree, the option is to be seen as distinct from the later re-purchase of the vehicle. It should be taken up as a liability (deferred income) when granted (typically on sale of the vehicle). The amount of the liability is the option premium; if not specifically agreed, this can be estimated, e.g. from the difference between the rebates granted on sales with, or without, the option. The liability should be carried forward until exercise or expiry, at which point it should be released to income. No provision may be made with tax effect for any anticipated loss on subsequent disposal of the vehicle, in view of the statutory prohibition on provisions for future losses.

The holder of the vehicle must treat the option in a corresponding fashion. He takes up the option as an asset at cost to be carried forward undiminished throughout the option term. The cost is the same as the liability taken up by the dealer, although the decree is silent on how the customer might find out what this is. The asset is written off to expense when the option terminates by exercise or expiry.

Keywords

buy-back, motor trade, put option