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Ronald, McDonald's and the case of pre-paid rent

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[McDonald's restaurant franchisees around Australia](#) could be facing bigger tax bills after the Federal Court found payments described as "prepaid rent" were actually outgoing capital, and not claimable in annual returns.

In a case set to be closely watched by [commercial tenants struggling with the financial impact of COVID-19](#), the court considered a franchise agreement with a family trust linked to one of the "fast-food power couples" of NSW, Ronald and Sandra Mussalli.

Part of the agreement for the Mussalli Family Trust to operate seven McDonald's restaurants included provisions for upfront payments related to some turnover, in order to secure a monthly rent reduction.

Described as pre-paid rent, the payments were worth almost \$10.5 million. The deductions claimed were spread over 10 years.

[Following an audit by the ATO](#), the Commissioner of Taxation denied the deductions and issued amended tax bills for the 2012 to 2015 income years.

Mr and Mrs Mussalli – recognised as the "big cheese" of the NSW Central Coast in a 2015 newspaper article – have owned McDonald's franchises since 2005.

In a ruling last month, the Federal Court found the trust's upfront payments were on the capital account, agreeing with the ATO that in the case of each restaurant,

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In a ruling last month, the Federal Court found the trust's upfront payments were on the capital account, agreeing with the ATO that in the case of each restaurant, the payments secured a more profitable business structure through a reduction in ongoing costs.

It said the non-refundable nature of the payments suggested they were not made to secure the right to occupy the premises, but were capital in nature.

Arnold Bloch Leibler tax partner Jonathan Ortner said other McDonald's franchisees with similar agreements were likely to be affected.

He said the central questions were what was the money really paid for, and is the reason for the payment really a capital asset?

"If the only advantage sought was the right to possession under the lease, and what was called 'rent' really answered that description, clearly the outgoings would be entirely of a revenue nature.

"If on the other hand one advantage sought by the outgoings was the acquisition of a capital asset – in this case a more profitable business structure – then the fact that the payments were called 'rent', would not necessarily prevent them from being in part outgoings of a capital nature."

Mr Ortner said while the issue of upfront lease payments wasn't new in business, the case served as a timely reminder for all tenants that describing an amount as rent doesn't automatically make it deductible.

"What is clear yet again from this case, is that the labels the parties choose to attach to a transaction are not determinative," he said.

"When a taxpayer disputes an assessment made by the Tax Office, it is the taxpayer that bears the burden of proving that the assessment is excessive. It is crucial that the taxpayer's relevant intention is supported by evidence."

Evidence would include documentation demonstrating the intent of any agreement.

“This decision will clearly require McDonald's franchisees to consider how they may have treated any upfront payments they have made under similar arrangements.

"However, for commercial tenants struggling with the impact of COVID-19, their very survival rests not with the rules and regulations of the pre-pandemic property world, but in dialogue and negotiation of new contractual arrangements."