



# Deductions for prepaid expenses 2025

A guide to help you work out deductions you can claim for expenses you prepay for a later income year.

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# General information about prepaid expenses

What prepaid expenses are and the prepayment rules.

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## What is a prepaid expense?

A prepaid expense is expenditure you incur under an agreement for something to be done (in whole or in part) in a **later** income year.

If you incur expenditure for something completed in full **this** income year (1 July 2024 to 30 June 2025), it isn't a prepaid expense, and the prepayment rules don't apply.

### Example: expenditure that isn't a prepaid expense

Jasmin is a solicitor. On 1 July 2024, she pays \$1,500 for an annual subscription for the monthly provision of a professional journal. The subscription covers the period 1 July 2024 to 30 June 2025.

The prepayment rules won't apply because the provision of the professional publication will be completed in 2024–25.

## What are the prepayment rules?

The prepayment rules alter the timing of deductions for certain prepaid expenses. These rules apply to prepaid expenses that would ordinarily be immediately deductible in full in the year in which they are incurred.

Generally, a prepaid expense is deductible over the '[eligible service period](#)'. The 'eligible service period' can't exceed 10 years.

A prepaid expense may be immediately deductible if:

- it is 'excluded expenditure'
- 'the 12-month rule' applies
- it relates to a 'pre-RBT (Review of Business Taxation) obligation'.

The prepayment rules **only** apply to amounts that would be deductible under the **general deductions** or certain research and development (R&D) provisions.

Special rules apply to prepayments under tax shelter arrangements.

## What is the eligible service period?

The eligible service period is the period during which the goods or services thing under the agreement are provided to the taxpayer in return for the expenditure. This may include expenditure for the provision of a series of goods, services, licenses, leases and memberships to professional associations.

The eligible service period begins on the later of:

- the day the goods or services under the agreement are provided
- on the day the expenditure is incurred.

The eligible service period continues until the earlier of:

- the end of the last day the good or service under the agreement ceases to be provided
- 10 years.

### Example: eligible service period

Mike runs a delicatessen from leased premises. On 1 December 2024, Mike makes a lease payment to cover the period 1 December 2024 to 31 December 2025. The eligible service

period for this expenditure therefore starts on 1 December 2024 and ends on 31 December 2025, a period of 397 days.

Mike's income year ends on 30 June of each year. The prepayment rules will apply as the provision of premises by the lessor isn't wholly done within the expenditure year.

## What is excluded expenditure?

Certain types of expenditure are excluded from the prepayment rules. These are:

- amounts of less than \$1,000 (excluding input tax credits)
- amounts required to be incurred by a court order or law of the Commonwealth, state or territory
- payments of salary or wages (under a contract of service)
- amounts that are capital, private or domestic in nature (except certain research and development amounts)
- certain amounts incurred by a general insurance company in connection with the issue of policies or the payment of reinsurance premiums.

### **Example: expenditure required to be incurred under a state law**

John operates a cartage business and pays \$1,200 on 31 December 2024 to register his truck for 12 months from 1 January 2025 to 31 December 2025. The truck is used exclusively for business purposes.

Although the registration fee is over \$1,000 and it covers a period spreading across more than one income year, it is excluded expenditure. This is because it is required to be incurred under a state or territory law.

The prepayment rules don't apply to this type of expenditure and the fee is deductible in the year it is incurred.

### **Example: expenditure incurred by an entity that is registered for GST**

Maree is registered for GST. On 30 June 2025 she prepays expenditure for services to be provided by another registered entity over the period 1 July 2025 to 30 June 2027.

The services to be provided are a taxable supply and Maree has acquired the services solely for a creditable purpose. The amount of the prepaid expenditure is \$1,045 which includes GST of \$95.

Maree's prepaid expenditure is tax deductible (a deductible loss or outgoing). Maree has met the requirements to be entitled to an input tax credit. The prepaid expenditure will be reduced by the input tax credit of \$95 so the prepaid expenditure amount is \$950. As the \$950 prepaid expenditure is less than \$1,000, it is excluded expenditure and is deductible in 2024–25 income year.

### **What is the 12-month rule?**

If you're a **small business entity** or would be a small business entity if the aggregated turnover threshold was \$50 million, or an individual incurring **deductible non-business expenditure**, you can claim an immediate deduction.

You can claim the deduction under the 12-month rule for prepaid expenditure if:

- the payment is incurred for an eligible service period not exceeding 12 months
- the eligible service period ends in the next income year.

Prepaid expenditure incurred under certain managed investments (tax shelter arrangements) isn't eligible for the 12-month rule. If the 12-month rule doesn't apply, your deduction for prepaid expenditure is apportioned over the eligible service period or 10 years, whichever is less.

### **What is a pre-RBT obligation?**

A pre-RBT obligation is any contractual obligation that:

- exists under an agreement at or before 11:45 am (by legal time in the ACT) on 21 September 1999, the date of the government's release of the Review of Business Taxation (RBT)
- requires you to make a prepayment in return for something to be done under the agreement
- can't be avoided by your own actions.

There are rules for deducting prepaid expenses incurred under a pre-RBT obligation. The rules are the same as those for **small business entities** and entities that would be small business entities if the aggregated turnover threshold was \$50 million and they have chosen to claim an immediate deduction.

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## General deductions and research and development

What are the general deduction and R&D provisions.

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### General deduction provisions

The prepayment rules apply **only** to expenditure which would otherwise qualify for immediate deduction:

- under the **general deduction provisions** of section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- for eligible companies, under the R&D provisions in sections 355-205 (R&D expenditure) or 355-480 (earlier year associate R&D expenditure) of the *ITAA 1997*.

The prepayment rules don't apply where the expenditure is deductible under a **specific deduction provision** of the tax law **other than** those

for R&D (that is, other than sections 355-205 or 355-480 of the *ITAA 1997*).

The general deduction provisions generally allow you to deduct from your assessable income any loss or outgoing incurred in either:

- gaining or producing your assessable income
- carrying on a business.

You can't claim a deduction under these provisions for expenditure that is either:

- of a capital, private or domestic nature
- incurred in gaining exempt or non-assessable non-exempt income.

Unless specifically stated otherwise, **expense** and **expenditure** refer to expenditure that is only allowable as a deduction under the general deduction provisions of section 8-1 of the *ITAA 1997* or, for eligible companies, under the R&D provisions in sections 355-205 or 355-480 of the *ITAA 1997*.

## R&D expenditure prepaid before 1 July 2011

Sections 355-205 and 355-480 of the *ITAA 1997* apply to R&D expenditure incurred since 1 July 2011. Undeducted amounts of prepaid expenditure incurred before 1 July 2011, but considered to be incurred over the eligible service period to which they relate, may be deductible under the transitional rules for the R&D tax incentive for income years beginning on or after 1 July 2011. The expenditure must be incurred on activities that the company has registered under section 27A of the *Industry Research and Development Act 1986* for the relevant year.

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# Investments in tax shelter arrangements

About tax shelter arrangements, expenditure to exclude from these rules and how to calculate a deduction.

**Last updated** 29 May 2025

## What is a tax shelter arrangement?

You have a tax shelter arrangement in the income year in which you incur prepaid expenditure (the expenditure year), if all the following apply:

- your allowable deductions (attributed to the expenditure year) exceed your assessable income from the arrangement for that year
- you don't have day-to-day control over the operation of the arrangement
- at least one of the following is met
  - more than one taxpayer participates as an investor in the arrangement
  - the manager, arranger or promoter of the arrangement, or an associate, carries out similar activities for other taxpayers.

## What expenditure is excluded from the tax shelter rules?

The following prepaid expenditure is excluded from the application of the tax shelter rules. This is provided the arrangement is conducted at arm's length and that you have or can reasonably expect to obtain rent, dividends or trust income:

- premiums for building insurance, contents insurance or rent protection insurance
- interest on money borrowed to acquire any of the following
  - real property or an interest in real property



- shares listed on an approved stock exchange
- units in a widely held unit trust which has at least 300 beneficiaries.

You also mustn't have obtained and won't obtain any other kind of assessable income (except a capital gain or insurance receipt) from the arrangement.

Also specifically excluded from the application of the tax shelter rules is:

- expenditure incurred under a contract (requiring prepayment for something to be done under the agreement) entered into before 1:00 pm (by legal time in the ACT) on 11 November 1999 that you can't avoid by your own actions
- expenditure under an agreement covered by a favourable ATO product ruling, where the ruling was made (or an application received and acknowledged by the Commissioner) before 1:00 pm (by legal time in the ACT) on 11 November 1999
- any prepaid expenditure which is excluded expenditure including
  - an amount below \$1,000
  - an amount required to be incurred by a law or a court order
  - an amount of salary or wages
  - an amount that is capital, private or domestic in nature (except certain research and development amounts)
  - certain amounts incurred by a general insurance company in connection with the issue of policies or the payment of reinsurance premiums.

If you incur prepaid expenditure that isn't subject to any of the above exceptions, you must determine your deduction according to the other rules explained in this guide.

## Summary of rules

Summary of the tax shelter arrangement rules:

- If you invest in a tax shelter arrangement, you need to be aware that the rules for prepayments may apply to limit your immediate

deductions.

- If you prepay expenditure under a tax shelter agreement for a thing that won't be wholly done within the expenditure year and it isn't covered by one of the exclusions listed above, you can't deduct all of the expenditure in the income year in which it was incurred. The deduction must be apportioned over the eligible service period or 10 years, whichever is less.
- An agreement for a tax shelter arrangement is one that covers any activities that relate to the arrangement, including those that give rise to deductions or assessable income. For example, if you invest in a tax shelter arrangement and prepay interest on a loan from a third party to pay management fees for the tax shelter, the prepaid interest on the loan would also be subject to the tax shelter rules.

## Calculating your deduction for a prepayment made under a tax shelter arrangement

To work out your deduction for prepaid expenditure that is affected by the tax shelter rules, use the following formula:

**A multiplied by (B divided by C)**

Where:

- **A** is expenditure.
- **B** is the number of days of eligible service period in the income year.
- **C** is the total number of days of eligible service period.

### Example: investment in a tax shelter arrangement

On 30 April 2025, Marion invests in an olive grove venture. The investment has all the characteristics of a tax shelter arrangement and isn't subject to any of the exceptions.

Under the terms of the agreement, Marion is required to pay an initial management fee of \$10,000 on 1 May 2025.

The payment will cover the provision of services over the period 1 May 2025 to 30 April 2026 (a period of 365 days). Marion made this payment on 1 May 2025.

Marion is required to apportion her deduction over the income years 2024–25 and 2025–26.

Marion calculates her deductions as follows:

**2024–25** (1 May 2025 to 30 June 2025)

$\$10,000 \times (61 \div 365) = \$1,671$

**2025–26** (1 July 2025 to 30 April 2026)

$\$10,000 \times (304 \div 365) = \$8,329$

The total deduction allowed proportionately over the income years 2024–25 and 2025–26 is \$10,000.

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## Deductible non-business expenditure

What is non-business expenditure, deductibility rules and calculating a deduction if the 12-month rule is satisfied.

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### What is non-business expenditure?

Non-business expenditure is any expenditure you incur in gaining assessable income from activities that don't relate to carrying on a business.

The most common forms of non-business expenditure are amounts incurred by individual taxpayers in gaining their assessable salary and wage income. Other examples include certain expenditure made for a rental property or shares held purely as a passive investment.

### **Example: non-business expenditure**

Ian is employed as a bank manager and the primary source of his income is the salary received from his employer. Ian also owns a rental property from which he receives assessable income. Ian's rental property activities don't constitute the carrying on of a business. Ian may prepay expenses for the rental property or for work-related expenses. This will be subject to the prepayment rules that apply to deductible non-business expenditure incurred by an individual.

## **Summary of rules including the 12-month rule**

Summary of rules including the 12-month rule for non-business expenditure:

- Prepaid expenditure that is subject to the **tax shelter rules** is apportioned over the eligible service period or 10 years, whichever is less.
- If you're an individual, your prepaid non-business expenditure is immediately deductible under the 12-month rule if either
  - the eligible service period for the expenditure is 12 months or less
  - the period ends no later than the last day of the income year following the year in which the expenditure was incurred.
- When the eligible service period is more than 12 months or it ends after the last day of the next income year, you apportion your deduction for prepaid non-business expenditure over the lesser of either
  - the eligible service period
  - 10 years.

## Calculating your deduction if the 12-month rule is satisfied

You're entitled to deduct that expenditure in the income year it was incurred if all the following apply:

- you incur prepaid non-business expenditure
- its eligible service period is 12 months or less
- the eligible service period ends on or before the last day of the next income year.

### Example: deduction for non-business expenditure with an eligible service period of 12 months or less

On 1 June 2025 Jasmin, an employed solicitor, paid \$1,750 for a subscription for a monthly professional journal for 1 June 2025 to 31 May 2026. The provision of the journal is the 'service to be done under the agreement'. The period of subscription is wholly within a 12-month period ending before the last day of the next income year. So, Jasmin is entitled to a deduction for the expenditure in 2024–25.

## Calculating your deduction if the 12-month rule isn't satisfied

If you incur prepaid non-business expenditure and the eligible service period is more than 12 months or it ends after the last day of the next income year, you must use the following formula to work out your deduction:

**A multiplied by (B divided by C)**

Where:

- **A** is expenditure.
- **B** is the number of days of the eligible service period in the income year.
- **C** is the total number of days of the eligible service period.

### **Example: deduction for non-business expenditure with an eligible service period of more than 12 months**

On 1 January 2025, Martin, a senior clerk employed by a legal firm, paid \$1,250 for a subscription for a monthly professional journal. The subscription is for 1 January 2025 to 31 January 2026 (395 days). As the eligible service period is more than 12 months, Martin must apportion his deduction over the income years 2024–25 and 2025–26. Martin's deductions are:

**2024–25** (1 January 2025 to 30 June 2025)

$$\$1,250 \times (182 \div 397) = \$573$$

**2025–26** (1 July 2025 to 31 January 2026)

$$\$1,250 \times (215 \div 397) = \$677$$

The total deduction allowed proportionately over the income years 2024–25 and 2025–26 is \$1,250.

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## **Small business entities**

What are small business entities, a summary of rules and calculating a deduction if the 12-month rule is satisfied.

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## **Are you a small business entity?**

You're a **small business entity** if you're an individual, partnership, company or trust that:

- is carrying on a business
- has an aggregated turnover of less than \$10 million.

**Aggregated turnover** is your annual turnover plus the annual turnovers of any businesses you're connected with or an affiliate of. The aggregation rules determine when you need to include the annual turnover of another business when calculating your aggregated turnover.

You're a small business entity if you're not linked with any other business and your business turnover is less than \$10 million.

## Summary of rules

Prepaid expenditure that is subject to the **tax shelter rules** is apportioned over the eligible service period or 10 years, whichever is less.

Prepaid expenditure incurred by a small business entity or an entity that would be a small business entity if the aggregated turnover threshold was \$50 million is immediately deductible under the 12-month rule if either:

- the eligible service period for the expenditure is 12 months or less
- the period ends no later than the last day of the income year following the year in which the expenditure was incurred.

This rule, known as the 12-month rule, applies to both deductible business and non-business expenditure incurred by a small business entity and an entity that would be a small business entity if the aggregated turnover threshold was \$50 million that chooses to use this concession.

If a prepayment doesn't meet the 12-month rule, you can't claim an immediate deduction. Small business entities and entities that would be small business entities if the aggregated turnover threshold was \$50 million must apportion the deduction over the eligible service period or 10 years, whichever is less.

## Small business entities still using the simplified tax system (STS) accounting method

You may continue using the STS accounting method if you:

- were an STS taxpayer and used it until the end of the 2006–07 income year
- continued to use the STS accounting method up to the most recent income year
- are a small business entity in the current year.

If you meet these requirements, you can continue using the STS accounting method until you choose not to or are no longer a small business entity.

If you're a small business entity using the STS accounting method, the expense must have been incurred and paid before a deduction can be claimed.

## Calculating your deduction if the 12-month rule is satisfied

### **Example: prepaid expense that is immediately deductible**

The Jacobs Trust is a small business entity. On 1 June 2025, it made a payment of \$24,000 to cover the lease of its business premises for a 12-month period commencing on 1 July 2025 and ending on 30 June 2026.

The prepayment satisfies the 12-month rule as the eligible service period for the expenditure:

- doesn't exceed 12 months
- ends on or before the last day of the income year following the year in which the expenditure was incurred.



The Jacobs Trust can therefore choose to claim an immediate deduction of \$24,000 in 2024–25.

## Calculating your deduction if the 12-month rule isn't satisfied

If you make a prepayment that doesn't satisfy the 12-month rule, you can't claim an immediate deduction.

If you're a small business entity or would be a small business entity if the aggregated turnover threshold was \$50 million, you must apportion the deduction over the lesser of either:

- the eligible service period
- 10 years.

Use the following formula:

**A multiplied by (B divided by C)**

Where:

- **A** is expenditure.
- **B** is the number of days of eligible service period in the income year.
- **C** is the total number of days of eligible service period.

### Example: prepaid expense where eligible service period is greater than 12 months

Tom Pty Ltd is a small business entity. On 31 May 2025, it paid \$15,000 for business advertising to cover the period 1 June 2025 to 30 June 2026 (395 days). Because the eligible service period is longer than 12 months, the prepayment doesn't satisfy the 12-month rule. Tom Pty Ltd can't claim an immediate deduction for the prepayment. Instead, the deduction for the expenditure must be apportioned over the eligible service period as follows:

**2024–25** (1 June 2025 to 30 June 2025)

$$\$15,000 \times (30 \div 395) = \$1,139$$

**2025–26** (1 July 2025 to 30 June 2026)

$$\$15,000 \times (365 \div 395) = \$13,861$$

The total deduction allowed proportionately over the income years 2024–25 and 2025–26 will be \$15,000.

**Example: prepaid expense where the eligible service period is 12 months or less but ends after the last day of the next income year**

Noel Pty Ltd, a small business entity, was offered a 15% discount on advertising to cover the period 15 July 2025 to 14 July 2026 (365 days), providing payment was made by 30 June 2025. Noel Pty Ltd accepted these conditions and paid \$10,200 for these services on 30 June 2025.

Although the eligible service period is for a period of 12 months or less, the 12-month rule hasn't been satisfied. This is because the eligible service period doesn't end on or before the last day of the income year following the one in which the expenditure was incurred. The deduction for the expenditure must be apportioned over the eligible service period as follows:

**2024–25**

Nil. No part of the eligible service period occurred in this income year although expenditure for the service period occurred in this income year.

**2025–26** (15 July 2025 to 30 June 2026)

$$\$10,200 \times (351 \div 365) = \$9,809$$

**2026–27** (1 July 2026 to 14 July 2026)

$$\$10,200 \times (14 \div 365) = \$391$$

The total deduction allowed proportionately over the income years 2025–26 and 2026–27 will be \$10,200.

For more information, see:

- Business and professional items schedule instructions 2025
- Company tax return and instructions 2025
- Partnership tax return and instructions 2025
- Trust tax return and instructions 2025

## Carrying on a business while incurring deductible business expenditure

If you're a small business entity or would be a small business entity if the aggregated turnover threshold was \$50 million, see [Small business entities](#).

### Summary of rules

- If you're carrying on a business and aren't a small business entity and your aggregated turnover is \$50 million or more, you must apportion your deduction for prepaid business expenditure over the lesser of either:
  - the eligible service period
  - 10 years.
- Prepaid expenditure that is subject to the **tax shelter rules** is apportioned over the lesser of either:
  - the eligible service period
  - 10 years.
- If you're not an individual, a small business entity or an entity that would be a small business entity if the aggregated turnover threshold was \$50 million, your deduction for prepaid non-business expenditure is apportioned over the lesser of either:
  - the eligible service period
  - 10 years.
- If you're an individual, your prepaid non-business expenditure is immediately deductible under the 12-month rule if:
  - the eligible service period for the expenditure is 12 months or less

- the period ends no later than the last day of the income year following the year in which the payment is made.
- If you're an individual and the eligible service period is more than 12 months or it ends after the last day of the next income year, your deduction for prepaid non-business expenditure is apportioned over either the lesser of either:
  - the eligible service period
  - 10 years.

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