



Taxation Determination

Income tax: is the cost of a depreciating asset purchased by a taxpayer to assist them undertake a specific client project immediately deductible under section 8-1 or written off over the effective life of the asset under section 40-25 of the *Income Tax Assessment Act 1997* if the taxpayer continues to hold the asset after the project ends?

❶ This Ruling provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*. A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes. If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

Ruling

1. The cost of the depreciating asset is not immediately deductible under section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997). It is written off as a deduction for decline in value over the effective life of the asset under section 40-25 of the ITAA 1997.
2. If the taxpayer continues to hold and use the asset for a taxable purpose after the project is completed, they can continue to claim a deduction for the decline in value of the asset.
3. If, at the completion of the project, the taxpayer still holds the asset but stops using it and expects never to use it again, a balancing adjustment event occurs for the asset. The taxpayer needs to work out a balancing adjustment amount to either include in their assessable income or claim as a deduction (section 40-285 of the ITAA 1997).

Example 1: continue to hold and use the asset

4. *The taxpayer, a mineral testing laboratory, was contracted by one their clients to undertake a test of the client's mineral sand pilot plant. On 1 January 2005, the taxpayer acquired a custom made plastic 60kg attritioning unit they required to undertake the testing. The testing program was completed within 2 months after which time the taxpayer continued to hold the asset in the expectation they would have a future use for it. A balancing adjustment event did not occur for the asset even though the unit may lay idle for the period up to and including 30 June 2005.*

5. *In their 2005 income tax return, the taxpayer is entitled to claim a deduction for the decline in value of the unit for the 6 months they held it. As the unit was not used for a purpose other than a taxable purpose, there is no need to reduce the taxpayer's deduction for decline in value. No balancing adjustment event occurred for the asset and, therefore, there is no need to work out a balancing adjustment amount.*

Example 2: stop holding or stop using the asset

6. *If, on the other hand, the taxpayer decided they had no further use for the unit, and expected never to use it again, a balancing adjustment event would have occurred for the asset. In their 2005 income tax return, the taxpayer is entitled to claim both the decline in value deduction for the 2 months the unit was used in the project and a balancing adjustment amount.*

Date of effect

7. This Ruling applies from 1 July 2001. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the Ruling.

Commissioner of Taxation

10 May 2006

Appendix 1 – Explanation

❶ ***This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.***

Explanation

8. Section 8-1 of the ITAA 1997 provides an immediate deduction for a loss or outgoing to the extent it is incurred in gaining or producing assessable income or is necessarily incurred in carrying on a business for that purpose. However, the section precludes a deduction for a loss or outgoing of capital (*Sun Newspapers v. FC of T* (1936) 61 CLR 337; 5 ATD 87). Expenditure on acquiring a depreciating asset is normally capital and, therefore, not deductible under the section.

9. The fact that the cost of a depreciating asset is incurred in assisting to undertake a project for which the taxpayer is paid an assessable fee is irrelevant in determining the deductibility of the cost of the asset. An amount of expenditure is only allowed as a tax deduction when it satisfies the provisions of the law governing its deductibility. The character of the expenditure should never be confused with the character of the receipt associated with that expenditure (*GP International Pipecoaters Pty Ltd v. FC of T* 90 ATC 4413; 21 ATR 1).

10. Subsection 40-25(1) of the ITAA 1997 provides an annual deduction to a holder of a depreciating asset for an amount equal to the decline in value of the asset. Under the general provisions of Subdivision 40-B of the ITAA 1997, decline in value is worked out by using the formula for either the diminishing value method or the prime cost method (sections 40-70 and 40-75 of the ITAA 1997). A depreciating asset declines in value when it is used, or installed ready for use, for any purpose (section 40-60 of the ITAA 1997). Under subsection 40-25(2) of the ITAA 1997, the annual deduction is reduced by the part of the asset's decline in value that is attributable to the holder's use of the asset for a purpose other than a taxable purpose.

11. Where a taxpayer acquires and uses a depreciating asset to assist them to undertake a particular project for which they are paid an assessable fee, they are using the asset for a taxable purpose. Therefore, they can claim a deduction for the decline in value of the asset for the period the asset is held and used in the project.

12. If the taxpayer continues to hold and use the asset for a taxable purpose after the project is completed, they can continue to claim a deduction for the decline in value of the asset.

13. Under the formulae used to work out the decline in value of a depreciating asset in sections 40-70 and 40-75 of the ITAA 1997, the decline in value is worked out for the number of days in an income year that the taxpayer held the asset. The number of days the asset is held excludes any days in the income year when the taxpayer did not use the asset, or have it installed ready for use, for any purpose.

14. Therefore, if, at the completion of the project, the taxpayer still holds the depreciating asset but stops using it, the taxpayer cannot claim a deduction for the decline in value of the asset for the number of days in the income year that the asset was not used or installed ready for use.

15. Where the decline in value of a depreciating asset is worked out under the general provisions in Subdivision 40-B of the ITAA 1997, a balancing adjustment event occurs for that asset when the taxpayer stops using it, or having it installed ready for use, for any purpose and expects never to use it, or have it installed ready for use again (paragraph 40-295(1)(b) of the ITAA 1997).

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16. Therefore, if, at the completion of the project, the taxpayer still holds the asset but stops using it and expects never to use it again, a balancing adjustment event occurs for the asset. The taxpayer needs to work out a balancing adjustment amount to either include in their assessable income or claim as a deduction (section 40-285 of the ITAA 1997).

References

Previous draft:

Not previously issued as a draft

- ITAA 1997 40-25
- ITAA 1997 40-25(1)
- ITAA 1997 40-25(2)

Previous Rulings/Determinations:

TD 93/189

- ITAA 1997 40-60
- ITAA 1997 40-70
- ITAA 1997 40-75
- ITAA 1997 40-285

Subject references:

- balancing adjustment event
- balancing adjustments
- decline in value
- uniform capital allowances system

- ITAA 1997 40-295(1)(b)
- ITAA 1997 Subdiv 40-E

Legislative references:

- TAA 1953
- ITAA 1997 8-1
- ITAA 1997 Subdiv 40-B

Case references:

- GP International Pipecoaters Pty Ltd v. FC of T 90 ATC 4413; 21 ATR 1
- Sun Newspapers v. FC of T (1936) 61 CLR 337; 5 ATD 87

ATO references

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