



Public advice and guidance compendium – TR 2024/1

❗ Relying on this Compendium

This Compendium of comments provides responses to comments received on draft Taxation Ruling TR 2023/D2 *Income tax: composite items – identifying the relevant depreciating asset for capital allowances*. It is not a publication that has been approved to allow you to rely on it for any purpose and is not intended to provide you with advice or guidance, nor does it set out the ATO's general administrative practice. Therefore, this Compendium does not provide protection from primary tax, penalties or interest for any taxpayer that purports to rely on any views expressed in it.

Summary of issues raised and responses

All legislative references in this Compendium are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.

Issue number	Issue raised	ATO response
1	Administrative concession for certain second element costs There is a significant compliance burden associated with treating 'additions' as second element costs of depreciating assets, particularly for taxpayers who use prime cost depreciation. This is because: - taxpayers need to recalculate the prime cost depreciation for the depreciating asset over its remaining effective life - the effective life needs to be recalculated where the second element increases the asset's cost by 10%. The ATO should consider providing an administrative concession, in the form of a safe harbour, to allow taxpayers in certain circumstances to treat additions as separate depreciating assets. The safe harbour could apply by choice where the cost of the addition is below a certain materiality threshold.	Noted, however no change has been made to the final Ruling. We confirm that: - subsection 40-75(2) requires taxpayers to modify their calculations under the prime cost method where a depreciating asset's effective life has been recalculated or an amount is included in the second element of the asset's cost - subsection 40-110(2) requires a depreciating asset's effective life to be recalculated in a case where a taxpayer uses the prime cost method and the asset's cost has increased by 10%. We do not consider an administrative concession as suggested is open under the law, having regard also to subsection 40-30(4) and section 40-190.

Issue number	Issue raised	ATO response
2	Example 1 – industrial storage racking The final Ruling should include further guidance on how to assess the effective life of a composite asset following the addition in circumstances such as those in Example 1 of the draft Ruling. For example, if the structural integrity of the original shelving unit is assessed as likely to fail after 20 years, guidance should be provided as to whether the assessment of useful life is to be based on the original shelving units, which make up a majority of the integrated asset, or on the new addition, which will continue in use after the original shelves have failed and are replaced.	Noted, however no change has been made to the final Ruling. Guidance on how to assess the effective life of a composite asset is outside the scope of this Ruling. See Effective life of a depreciating asset which explains the methodology used by the Commissioner in assessing the effective life of depreciating assets and may assist taxpayers in making their own estimate in accordance with section 40-105. The addition of new storage racks to an existing row in Example 1 (paragraph 36 of the final Ruling) is considered a modification to an existing depreciating asset. Therefore, any reassessment of effective life has regard to the matters in section 40-105 for that depreciating asset viewed as a whole.
3	Example 2 – desktop computer package (a) We do not agree with the logic used to reach the conclusions in Example 2 of the draft Ruling. We accept that a series of devices acquired together to serve a single purpose or function can be an integrated asset. It does not follow, however, that the replacement of one of the elements of an integrated asset should be treated as a separate asset solely because it could be used in another system or with other assets. This is particularly the case if, as a matter of fact, the sole reason for the acquisition is to replace an existing element of an integrated asset. (b) It would be helpful if the difference between the conclusions reached in relation to the printer (assuming it was purchased as part of the package) and the conclusion on the other assets in the package (for example, a mouse) was better articulated. Without further detail, it is arguable that the printer's function is as separately identifiable as the other assets.	No change has been made to the final Ruling. All of the items listed in Example 2 of the Ruling are separately identifiable assets that perform their own function. However, the factor that, on balance, supports a conclusion that the desktop computer, monitor, wireless keyboard and mouse could be considered a single depreciating asset is that they were purchased to provide a single, integrated system intended to function as a whole. The printer performs its own separate function and is capable of independent existence.

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4	Example 2 – desktop computer package and Example 14 – photographic lighting equipment It is difficult to rationalise the conclusions reached in Example 14 of the draft Ruling when compared to Example 2 of the draft Ruling, as it seems that the qualities possessed by the photographic equipment apply equally to the computer package assets. More explanation as to the reasoning behind the conclusions is needed.	No change has been made to the final Ruling. Example 14 of the final Ruling can be distinguished from Example 2 of the final Ruling on the basis that none of the lighting equipment and accessories are integrated with the flash head or the generator – each have their own independent function, which is to vary the performance of the unit they are attached to. Example 2 of the final Ruling recognises that, notwithstanding the items in the desktop computer package are easily separated and may have been acquired from different suppliers, they were purchased to provide a single, integrated system intended to function as a whole. As noted in paragraph 40 of the final Ruling, if the items were acquired in different circumstances, they would be separate depreciating assets.
5	Example 3 – mainframe computer and Example 13 – solar power system It is not clear why the new terminals in Example 3 of the draft Ruling (which are dependent on the mainframe for their functionality) are separate depreciating assets, but the new solar panels in Example 13 of the draft Ruling are not.	In Example 3 of the final Ruling, the new terminals are treated as separate depreciating assets as they have a separate identifiable function, were purchased 'off-the-shelf' and can be easily connected to any compatible mainframe computer system. In Example 13 of the final Ruling – by contrast – the additional solar panels that were purchased have been designed to work with the original solar power system, which was itself tailored to the purchaser's needs. We have sought to clarify that the additional panels were specifically designed to work with the original system in paragraph 78 of the final Ruling.
6	Example 13 – solar power system It is very common for batteries to be included with solar systems. Batteries are added to improve the functionality of the solar system for the owner. It would be beneficial to understand the ATO's views on the function of a solar system with a battery as it would provide additional guidance on assessing the function of other assets that are used together. For example, it can be submitted that the function of a solar system is to create energy independence for the owner, and a battery enhances this function. It can also be submitted that the function of a solar system is to generate electricity while a battery's function is to store the electricity.	No change has been made to the final Ruling. The characterisation of the battery will depend on the facts and circumstances of the case, including how the solar system is designed. However, we would generally expect the battery to be a separate depreciating asset from the solar power system. This is because the battery has a separately identifiable function being the storage and release of energy, while the solar system generates power. We think it can be distinguished from the other components of the solar system in Example 13 of the final Ruling.

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7	Variations to examples Many of the examples in the draft Ruling would benefit from an enhancement to alter key facts and outline whether or not a different conclusion is reached in other circumstances. For example, in Example 13 of the draft Ruling, if the inverter was replaced after 5 years due to a malfunction and it was replaced with current technology with the same role in the system, commentary should be provided on whether this is a repair, a second element or a separate asset. If it is concluded that it is a repair, an explanation should be provided as to why this outcome differs from the conclusion on the computer screen in Example 2 of the draft Ruling if the inverter could also theoretically be removed from the original solar system and used with another solar system.	Noted, however no changes have been made to the final Ruling. We think it clear from the legislation (subsection 40-30(4)) and the Ruling (paragraphs 6 and 7) that: • Whether a particular composite item is itself a depreciating asset, or whether one or more of its components are separate depreciating assets is a question of fact and degree to be determined in the circumstances of the particular case. • Every enquiry requires the exercise of judgment in the prevailing factual circumstances. A composite item may be a single depreciating asset in one taxpayer's circumstances but not in another's. It necessarily follows that variations in facts may lead to a different conclusion. The purpose of the examples is to illustrate the principles in the Ruling, not to address different or narrow fact patterns.
8	Provision of additional examples (a) It would be useful to provide other examples in the final Ruling that demonstrate how the ATO would approach large assets with many components (as compared to a powerline, which is large but only has a few components). Examples of this are a smelter, a power station, a refinery and a brewery. (b) It would be helpful for the final Ruling to include more contemporary examples such as the use of assets with embedded technology in its role in decarbonisation. One such example is automated vehicles used on mine sites and identifying the relevant assets or assets for Division 40 purposes.	No changes have been made to the final Ruling in response to these comments. • Paragraphs 8 to 16 of the final Ruling include guiding principles to assist in identifying the relevant depreciating asset. The principles that the ATO would have regard to are the same whether there is a large asset with many components, or only a few. • It is not clear how the particular examples suggested would further enhance an understanding of the principles.