


***CR 2012/62 - Income tax: depreciating asset: small
business and general business tax break: BB
Australia Pty Ltd***

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Class Ruling

Income tax: depreciating asset: small business and general business tax break: BB Australia Pty Ltd

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① This publication 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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- Subsection 40-30(1) of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Subsection 40-30(2) of the ITAA 1997;
- Paragraph 41-10(1)(a) of the ITAA 1997;
- Subparagraph 41-10(4)(b)(ii) of the ITAA 1997; and
- Section 41-35 of the ITAA 1997.

All subsequent references in this Ruling are to the ITAA 1997 unless otherwise stated.

Class of entities

3. The class of entities to which this Ruling applies is Block Buster franchisees that acquire new DVDs, Blu-ray discs and HD-DVDs, during the period 13 December 2008 to 31 December 2009 inclusive, for the purpose of hiring them to the public.

Qualifications

4. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 9 to 25 of this Ruling.

6. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Date of effect

8. This Ruling applies from 1 July 2009 to 30 June 2010. However, this Ruling will 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 this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

9. The following description of the scheme is based on information provided by the applicant. The following documents, or relevant parts of them form part of and are to be read with the description:

- Application for class ruling dated 22 August 2011;
- The further information provided dated 9 February 2012; and
- The further information provided dated 16 May 2012.

10. The arrangement is known as the VEA Tax Break Arrangement.

11. The franchisees acquired new DVDs, blu-ray discs and the HD-DVDs from Block Buster Australasia Pty Ltd (the Applicant) or the Applicant's recommended suppliers or other wholesalers and retailers (collectively, the Applicant's suppliers) during the period 13 December 2008 to 31 December 2009 inclusive for the purpose of hiring them to customers in Australia.

12. The franchisees carry on a business of hiring DVDs, blu-ray discs and the HD-DVDs to customers. The DVDs, blu-ray discs and HD-DVDs were not purchased for resale and are not trading stock of the franchisees.

13. The DVDs, blu-ray discs and HD-DVDs are part of the plant and equipment used in the hiring business.

14. The transactions for the purchase of the DVDs, blu-ray discs or HD-DVDs did not confer on the franchisees a licence or other intellectual property right such as copyright.

15. The franchisees acquired:

- Multiple DVDs, blu-ray discs or HD-DVDs in various combinations depending on the trading requirements of the franchisee;
- Multiple copies of the same movie, TV series or soundtrack (collectively 'audiovisual content') or console or computer game software ('games') depending on the trading requirements of the franchisee; or
- A combination of discs containing different audiovisual content or games.

16. The first use of the DVDs, blu-ray discs and the HD-DVDs by the franchisee (or having them installed ready for use) takes place in the income year in which they were purchased and in any event no later than 31 December 2010.

17. The components of the DVDs, blu-ray discs and HD-DVDs include:

- The physical disc, all of which have the same dimensions and are made of the same material;
- The packaging;
- The cover image and sometimes a pamphlet with instructions or additional details; and
- The audiovisual content or games.

18. Although each type of disc looks the same in size and shape they differ in many respects, including storage capacity, laser technology, image resolution and player compatibility.

19. Each type of disc has different storage capacities, as follows:

- A dual layer DVD has capacity to hold approximately 9 GB of information. This is approximately equivalent to 4 hours of standard digital recording, but only approximately 30 mins of high definition digital recording;
- A dual layer HD-DVD has capacity to hold approximately 30 GB of information. This is approximately 15 hours of standard digital recording; and
- A dual layer Blu-ray disc has capacity to hold approximately 50 GB of information. This is approximately 26 hours of standard digital recording.

20. Each type of disc has different image resolution, as follows:

- DVDs have standard definition resolution of between 480 – 520 (number of horizontal lines);
- HD-DVDs have high definition resolution of between 780 -1080; and
- Blu-ray discs have full high definition resolution of 1080.

21. Each type of disc can only be played on a compatible player (disc player, computer or gaming console). Blu-ray discs cannot play on a standard DVD player because the red laser used in DVD players is too large to read the grooves in a Blu-ray disc.

22. Player compatibility with each type of disc is dependent on the laser projection lenses of the player, as follows:

- DVDs are read by red light (650nm spectrum) laser projection through lenses;
- HD-DVDs are read by red light (405nm spectrum) laser projection through lenses; and
- Blu-ray discs are read by blue violet light (405nm spectrum) laser projection through lenses.

23. The audiovisual content or games on each of the type of discs is digitised and stored as binary code.

24. The primary use of a disc containing audiovisual content is for the user to view the fixed content stored on the disc. For example, to view a movie, or an episode of a TV series. Interactive elements which may be accessed by the user of an audiovisual disc, such as scene selection or language selection, may assist the user's experience of viewing the content.

25. The primary use of a disc containing games is for the user to play the game using their skill to influence the course of the game. The user does this by using a game controller to interact with the gaming software contained on the disc. Interactive elements which are accessed by the user of a games disc are integral to the user's experience of playing the game.

Ruling

26. Each DVD, blu-ray disc or HD-DVD acquired by the franchisees is a 'depreciating asset', for the purposes of paragraph 41-10(1)(a).

27. The DVDs, Blu-ray discs and HD-DVDs acquired during the relevant period are not a 'substantially identical' group for the purposes of subparagraph 41-10(4)(b)(ii).

28. All discs containing audiovisual content and games acquired during the relevant period are not a 'substantially identical' group for the purposes of subparagraph 41-10(4)(b)(ii).

29. All the DVDs containing audiovisual content acquired during the relevant period are a 'substantially identical' group for the purposes of subparagraph 41-10(4)(b)(ii).

30. All the DVDs containing games acquired during the relevant period are a 'substantially identical' group for the purposes of subparagraph 41-10(4)(b)(ii).

31. All the Blu-ray discs containing audiovisual content acquired during the relevant period are a 'substantially identical' group for the purposes of subparagraph 41-10(4)(b)(ii).

32. All the Blu-ray discs containing games acquired during the relevant period are a 'substantially identical' group for the purposes of subparagraph 41-10(4)(b)(ii).

33. All the HD-DVDs containing audiovisual content acquired during the relevant period are a 'substantially identical' group for the purposes of subparagraph 41-10(4)(b)(ii).

34. All the HD-DVDs containing games acquired during the relevant period are a 'substantially identical' group for the purposes of subparagraph 41-10(4)(b)(ii).

Commissioner of Taxation

22 August 2012

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.*

35. Division 41 allows business entities to claim a deduction for an income year in respect of recognised new investment in eligible tangible depreciating assets which equals or exceeds the new investment threshold (the tax break).

Depreciating asset

36. To be eligible for the tax break, one of the conditions is that the asset must be a 'depreciating asset, other than an intangible asset': paragraph 41-10(1)(a).

37. 'Depreciating asset' is defined in subsection 40-30(1) as an asset that has a limited effective life and can reasonably be expected to decline in value over the time it is used except land, an item of trading stock and an intangible asset unless it is an intangible asset mentioned in subsection 40-30(2). Subsection 40-30(2) sets out the intangible assets which are depreciating assets.

38. Intangible assets not listed in subsection 40-30(2), such as CGT Assets, are excluded from paragraph 41-10(1)(a) because they are not depreciating assets as defined.

39. Paragraph 41-10(1)(a) operates at a further level to exclude intangible assets that are depreciating assets as defined, such as items of intellectual property.

40. When acquiring DVDs Blu-rays or HD-DVDs, the franchisees did not acquire any licence or other intellectual property right such as copyright.

41. A DVD, Blu-ray disc or HD-DVD including the digital content embedded in the disc is a tangible depreciating asset. Just as a textbook and the information contained therein is a tangible depreciating asset. This is so even where the cost or value of the physical material (such as plastic to make a disc) is significantly lower than the selling price of the disc or book.

42. It is considered that the DVDs, Blu-ray discs and HD-DVDs are tangible depreciating assets.

New investment threshold

43. The new investment threshold in relation to an asset is \$1,000 for an entity that is a small business entity during the income year in which occurs the investment commitment time for any recognised new investment for the asset in relation to the relevant income year; or during the income year in which occurs the first use time for any such amount; or during the relevant income year or otherwise it is \$10,000: section 41-35.

44. For the purposes of meeting the new investment threshold, businesses can aggregate their investment in assets that are identical or substantially identical: subparagraph 41-10(4)(b)(ii).

45. The terms 'identical' and 'substantially identical' are not defined in the ITAA 1997. Accordingly, the ordinary meaning and the ATO interpretation of the terms are considered.

The ordinary meaning of 'identical' and 'substantially identical'

46. The Macquarie Dictionary 2009 rev. 5th Edition (The Macquarie Library Pty Ltd, NSW) relevantly defines 'identical' as:

1. corresponding exactly in nature, appearance, manner etc.;
2. the very same,

and 'substantial' as:

7. relating to the substance, matter, or material of a thing;
8. of or relating to the essence of a thing; essential, material, or important.

47. It follows that assets will be identical if they are exactly the same in all respects.

48. Assets will be substantially identical if they are, in substance, or essentially, the same.

ATO interpretation of 'identical' and 'substantially identical' in Division 40

49. The expression 'identical or substantially identical' is also used to describe particular assets in Division 40 of the ITAA 1997.

50. In explaining how the ATO interprets these expressions, the Guide to Depreciating Assets 2008-09 (NAT 1996-6.2009) notes:

Items are identical if they are the same in all respects. Items are substantially identical if they are the same in most respects even though there may be some minor or incidental differences. Factors you would consider include colour, shape, function, texture, composition, brand and design.

The meaning of ‘substantially identical’ in Division 41

51. The meaning of the term ‘substantially identical’ for the purposes of subparagraph 41-10(4)(b)(ii) of the ITAA 1997 was considered in ATO Interpretative Decision ATO ID 2009/128 where the issue of whether arcade machines are substantially identical was considered.

52. The ATO ID noted that the meaning of the expression ‘substantially identical’ has been considered in court cases¹ in other legislative contexts and concludes that case authority supports the interpretation that to be described as substantially identical, assets must be the same in all essential and material respects. In making a judgement about whether assets are substantially the same, the material attributes or characteristics of the assets need to be identified and then compared. If these material characteristics are common to each asset, then this will support the conclusion that the assets are substantially identical. Assets can therefore be substantially identical despite having minor or incidental differences.

53. It is accepted that in a side by side comparison by the human eye that the physical appearance of each type of disc is substantially identical. However, the comparison is not limited to physical components. It can include intangible attributes particularly when those features are an integral part of the asset. Attributes which contribute to the viewing quality of a disc, such as the storage capacity, image resolution, access to the disc’s digital content, and the method of operation of the disc’s content are relevant to determine whether there are material differences between each of them.

Disc type

54. The storage capacity of DVDs, HD-DVDs and Blu-ray discs are significantly different resulting in differences in functionality. The different storage capacities have a material impact on the amount and type of digital content that is able to be stored on each type of disc. For example, a DVD does not have the capacity to store an entire high definition movie whereas HD-DVDs and Blu-ray discs do have the capacity. Accordingly, based on storage capacity the functionality of DVDs, HD-DVDs and Blu-rays are materially different.

¹ *Shell Co of Australia Ltd v. Esso Standard Oil (Australia) Ltd* (1963) 109 CLR 407; [1963] ALR 634; *Torpedoes Sportswear Pty Ltd v. Thorpedo Enterprises Pty Ltd* (2003) 204 ALR 90; (2003) 59 IPR 318; and *Kowa Company LTD v. NV Organon* (2005) 223 ALR 27; (2005) 66 IPR 131.

55. The way the digital content is embedded on each type of disc is different. This is evidenced by the fact that the laser (within the external device) required to read each type of disc is different. Once again the functionality of each type of disc is materially different, based on how the user of the disc is able to access the digital content of each disc type. For example, if a user has a DVD player they will be able to access the content on a DVD, but they will not be able to access the content on a Blu-ray disc.

56. The image resolution of each type of disc system is different. The greater the number of horizontal lines, the better the image resolution. DVDs have standard definition resolution of between 480 – 520. HD-DVDs have high definition resolution of between 780 – 1080. Blu-ray discs have full high definition resolution of 1080.

57. The total impression gained from the comparison of the DVDs, Blu-ray discs and HD-DVDs is that the attributes which contribute to the viewing quality of the digital content such as disc storage capacity, image resolution and accessing the content is that there are significant material differences between each type of disc such that they can not be considered as being essentially the same.

58. Therefore, the DVDs, blu-ray discs and HD-DVDs are not a 'substantially identical' group for the purposes of subparagraph 41-10(4)(b)(ii).

Disc content

59. Discs containing audiovisual content and discs containing games have different uses and different methods of operation or interactivity.

60. The primary use of a disc containing audiovisual content is for the user to view the fixed content stored on the disc. The method of operation of an audiovisual disc, in particular its interactive elements, supports this primary use. The interactive elements that may be accessed by the user of an audiovisual disc, such as scene selection or language selection merely assist or supplement the experience of viewing the fixed stored content. These elements have limited capacity to influence the outcome of a movie or episode of a TV series.

61. The primary use of a disc containing games is for the user to play the game using their skill to influence the course of the game. The user does this by using a game controller to interact with the gaming software contained on the disc. The interactive elements that are accessed by the user of a games disc are essential to, and integral to the user's experience of playing the game. These elements are accessed by the user to materially influence the course of, or the outcome of the game.

62. Whilst the discs containing audiovisual content and the discs containing games are physically similar, they have different uses and different methods of operation and they each provide a different level of entertainment. The fact that the physical discs look similar is not enough for them to be substantially identical.

63. For these reasons, it is considered that discs containing audiovisual content and discs containing games are not 'substantially identical' for the purposes of subparagraph 41-10(4)9b)(ii).

64. Accordingly, for discs acquired during the relevant period, the following are 'substantially identical' groups for the purposes of subparagraph 41-10(4)(b)(ii):

- All the DVDs containing audiovisual content;
- All the DVDs containing games;
- All the Blu-ray discs containing audiovisual content;
- All the Blu-ray discs containing games;
- All the HD-DVDs containing audiovisual content; and
- All the HD-DVDs containing games.

Appendix 2 – Detailed contents list

65. The following is a detailed contents list for this Ruling:

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- intellectual property
- small business

Legislative references:

- ITAA 1997 40-30(1)
- ITAA 1997 40-30(2)
- ITAA 1997 Div 41
- ITAA 1997 41-10(1)(a)
- ITAA 1997 41-10(4)(b)(ii)
- TAA 1953
- Copyright Act 1968

ATO references

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