


# ***TR 93/D14 - Income tax: depreciation deductions for lessees***

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## Draft Taxation Ruling

### Income tax: depreciation deductions for lessees

#### other Rulings on this topic

IT 175, IT 2519

contents	para
What this Ruling is about	1
Ruling	4
Explanations	6
Date of effect	15

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## What this Ruling is about

1. This Ruling considers whether a site lessee in a building construction financing arrangement is entitled to depreciation for plant or articles forming part of the building at the time it is constructed.
2. This Ruling reiterates the position regarding lessees and depreciation set down in Taxation Ruling IT 175.
3. This Ruling does not apply in cases of property installed on Crown land where the lessee is entitled to claim depreciation in respect of that property by virtue of the operation of section 54AA of the *Income Tax Assessment Act 1936* ('the Act').

## Ruling

4. Plant or articles forming part of a building at the time it is constructed are not fixtures in the generally accepted sense of that term. In a building construction financing arrangement involving a site lease, the building and the plant or articles forming part of it belong to the lessor notwithstanding that the site lessee erected the building. They cannot be "owned" by the lessee within the meaning of that word in section 54 of the Act.

5. This Ruling does not disturb the views expressed in paragraph 4 of IT 175. A lessee may claim depreciation in respect of plant or articles installed by the lessee in a pre-existing building if:

# TR 93/D14

- a) they are removable by the lessee under the terms of the lease;
- b) they are tenant's fixtures; or
- c) the lessee has a right under the lease to compensation for the value of fixtures annexed by the lessee.

## Explanations

6. A financing arrangement has recently come under notice concerning the construction of a building on land owned by an associate of an "exempt public body" as defined in subsection 159GE(1) of the Act. A site lease (the head lease) was granted to a nominee company owned by the financiers to the project which then undertook construction of the building. On completion of the building an underlease was entered into with an entity associated with the site lessor. The nominee company, as site lessee, derives rental income and is also to receive a large 'compensatory' payment at the expiry of the site lease. All payments flowing to the financiers (via the nominee) are predetermined and are guaranteed by the exempt public body.

7. The arrangement is structured with a view to avoiding the operation of Division 16D of Part III of the Act. Leaving aside that general question, one feature of the arrangement is that depreciation for plant or articles within the building is said to be an allowable deduction to the site lessee.

### Fixtures and Lessees: the Law

8. The position at law is that anything affixed to the freehold so as to become a fixture forms part of the freehold and therefore belongs to the owner of the land. Accordingly, any buildings or other improvements to the realty in place at the time land is leased belong to the lessor. So, too, do things that are affixed by a lessee so as to become a fixture unless a statutory provision provides otherwise. With certain limited exceptions, a lessee may not remove any fixtures at the expiry of the lease. The exceptions apply in situations involving the application of some special rule of law, statute or agreement. See the discussion in *Halsbury's Laws Of England*, Volume 27, paragraph 142 (4th edition).

9. A special rule of law applies to what are commonly known as "tenant's fixtures". The law relating to tenants fixtures is explained in volume 27 of *Halsbury's* at paragraph 147. After stating the general rule about fixtures it is then stated:

"The rule has, however, been relaxed to some extent as between landlord and tenant, and, even where an article has been attached to the demised premises by the tenant so as to become a fixture, if it has been affixed for the purposes of trade or ornament the tenant is entitled, in the absence of agreement to the contrary, to sever the article from the premises and to remove it."

In these cases, fixtures may be removed if they are capable of being severed from the land without irreparable injury to it.

### **Taxation Ruling IT 175**

10. The taxation treatment of fixtures annexed by a lessee on land not used for agricultural or pastoral pursuits was discussed in IT 175. Broadly, paragraph 4 of that Ruling recognises that the Commissioner accepts that a lessee may have a sufficient interest in the fixtures to be regarded as their owner for the purposes of the depreciation provisions of the Act. The Ruling indicates that depreciation deductions will be allowed to a lessee where the lease agreement provides a right to remove the fixtures, where the property is a tenant's fixture or if the lease provides a right to compensation for the value of fixtures annexed by the tenant.

11. The Ruling also states (in paragraph 5) that the taxation position will be different if the property is not a fixture within the commonly understood meaning of that term. In this regard, it was noted that the authorities generally agree that the term "fixture" does not include items that form part of a building at the time it is constructed; it is confined to things which have been affixed to the freehold after the original structure has been completed. See, for example, *Boswell v Crucible Steel Co. of America* [1924] All E.R. 298 and *Pole-Carew v Western Counties & General Manure Co.* [1920] All E.R. 274. The point is also made in volume 27 of *Halsbury's* at paragraph 149.

### **Application of IT 175**

12. The documentation in relation to the arrangement described in paragraphs 6 and 7 above provides that the site lessee has the right to remove the plant or articles at the termination of the lease. There will be a variation to the compensatory amount if the lessee waives its right to remove. However, it is clear from the overall nature of the arrangement that the intention of the parties concerned is that the plant or articles will not be removed from the building. Indeed, the very nature of the property - lifts, escalators, air conditioning plant etc., means that removal from the building would render the building inoperative for its intended function.

# TR 93/D14

13. Whilst the documentation attempts to create the impression that the situation conforms with the guidelines in paragraph 4 of IT 175, the arrangement overlooks the clear statement in paragraph 5 of IT 175 that in situations of this kind, the position at law is that the plant or articles are not fixtures in the generally accepted sense. The Ruling goes on to state that it should not be conceded that the property can be owned by the lessee despite any purported agreement to the contrary. Moreover, it is then stated:

"In this connection it does not seem to be relevant that the lessee may himself have incurred the expense of the construction of the building."

14. The views expressed in paragraph 5 of IT 175 are still considered to reflect the correct position at law and will continue to be followed by this Office. Accordingly, it is not accepted that an arrangement of the kind now under consideration entitles a lessee to deductions for depreciation in respect of the relevant plant or articles.

## Date of effect

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15. Representations have been made to this Office that the requirements of IT 175 have been generally misunderstood. A number of arrangements may have been entered into on the basis that depreciation deductions will be allowable for plant or articles installed by a lessee notwithstanding the views expressed in paragraph 5 of IT 175. It has been claimed that the ATO contributed to this misunderstanding some years ago by giving advance opinions which accepted arrangements that were either expressly or impliedly predicated on the site lessee claiming depreciation.

16. Apart from a small number of financing unit trust cases (discussed in Taxation Ruling IT 2512), arrangements expressly predicated on a site lessee obtaining depreciation deductions have not been given favourable advance opinions unless the circumstances were within the guidelines contained in IT 175. Whilst the opportunity was not taken in IT 2512 to make it clear that an objectionable feature of financing unit trust arrangements was the failure to follow the view of the law expressed in IT 175, a very clear statement about the intended effect of IT 175 was contained in paragraphs 5, 7 and 8 of Taxation Ruling IT 2519. That Ruling discusses in detail a proposed financing arrangement for the construction and establishment of a processing plant.

17. Following the issue of IT 2519, it was clear that cases involving lessees depreciating plant or articles that were not consistent with the view of the law expressed in IT 175 would not be accepted by the

ATO. It was also made very clear in Taxation Ruling IT 2500 (and reiterated in IT 2512) that a taxpayer could not rely on the contents of private rulings issued in respect of other taxpayers.

18. Accordingly, financing arrangements entered into after the date IT 2519 was published i.e., 27th February 1989, that are predicated on a lessee depreciating plant or articles will be treated strictly in accordance with the views expressed in IT 175 as discussed in this Ruling.

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**Commissioner of Taxation**

11 March 1993

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- Boswell v Crucible Steel Co. of America [1924] All ER 298
- Pole-Carew v Western Counties & General Manure Co. [1920] All ER 274

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- depreciation
- fixtures
- tenant's fixtures