TR 94/D31 - Income tax: deductions for repairs

This cover sheet is provided for information only. It does not form part of *TR 94/D31 - Income tax: deductions for repairs*

This document has been finalised by TR 97/23.

Draft Taxation Ruling
Income tax: deductions for repairs

contents	para
What this Ruling is about	**1**
Previous Rulings now withdrawn	**5**
Ruling	**6**
Date of effect	**36**
Explanations	**37**
Examples	**97**
Detailed contents list	**129**

Draft Taxation Rulings (DTRs) represent the preliminary, though considered, views of the Australian Taxation Office.

DTRs may not be relied on by taxation officers, taxpayers and practitioners. It is only final Taxation Rulings which represent authoritative statements by the Australian Taxation Office of its stance on the particular matters covered in the Ruling.

What this Ruling is about

1. This Ruling explains the circumstances in which expenditure incurred by a taxpayer for repairs is an allowable deduction under section 53 of the *Income Tax Assessment Act 1936* (the Act). It deals with:

(a) the meaning of the word 'repairs' in subsection 53(1);

(b) repair expenditure of a capital nature;

(c) the distinction between repair and either renewal or reconstruction - what is meant by the 'entirety';

(d) the distinction between a repair and an improvement;

(e) expenditure to remedy wear or damage in existence at the date of acquisition (initial repairs);

(f) expenditure incurred by a taxpayer on repairs to property that the taxpayer does not own;

(g) expenditure for repairs before premises, plant, etc is held, occupied or used for income producing or business purposes;

(h) expenditure for repairs after premises, plant, etc ceases to be held, occupied or used for income producing or business purposes;

(i) expenditure for repairs to property previously used for non-income producing purposes; and

(j) expenditure for repairs to property used only partly for income producing purposes during a year of income.

2. This Ruling does not consider in any detail the circumstances in which a loss or outgoing for repairs may be deductible under

subsection 51(1) or 54(1). Repairs may include some maintenance work but it may not include all maintenance work. If non-capital maintenance work is not a repair it may be deductible under subsection 51(1) (the general deduction provision). If expenditure on maintenance work is of a capital nature, it may be depreciable under subsection 54(1).

3. If expenditure on repairs is potentially deductible under both subsections 53(1) and 51(1), we consider that it is more 'appropriate' in terms of the exercise of the discretion in subsection 82(1) (no double deductions) that the deduction be allowed under subsection 53(1) rather than 51(1): see Case Q 98, 83 ATC 487 at 489; Case 26 (1983) 27 CTBR (NS) 158 at 160. In any event, our view is that if expenditure on repairs is deductible under the general deduction provision of subsection 51(1), it is also deductible (and would be expected to be deductible to the same extent) under the specific deduction provision of subsection 53(1), when read with subsection 53(3).

4. The Ruling does not deal with any capital gains tax issues that may arise in relation to repairs of a capital nature or other improvements to assets.

Previous Rulings now withdrawn

5. This Ruling replaces Taxation Rulings IT 153, IT 180, IT 2089, IT 2116, IT 2149, IT 2183 and IT 2587 and Taxation Determination TD 92/180. These Rulings and the Determination are now withdrawn.

Ruling

Meaning of the word 'repairs'

(see explanations at paragraphs 37 to 49 and examples at paragraphs 97 to 98 of this Ruling)

6. In its context in subsection 53(1), the word 'repairs' relates to work done to 'premises, part of premises, plant, machinery, implements, utensils, rolling stock or articles' (in this Ruling referred to as 'premises, plant, etc').

7. The word 'repairs' has its ordinary meaning. It ordinarily means the remedying or making good of defects in the premises, plant, etc to be repaired and contemplates the continued existence of the premises, plant, etc. Repair for the most part is occasional and partial. It involves restoration of the efficiency of function of the premises,

plant, etc being repaired and may include restoration to its former state or condition without changing its character. A repair merely replaces a part of something or corrects something which is already there and has become worn out or dilapidated. Works can fairly be described as 'repairs' if they are done to make good a deterioration that has occurred by ordinary wear or tear or by the operation of natural causes during the passage of time.

8. 'Repairs', in its context in subsection 53(1), is more directed to the holding, occupying or use of property for 'the purpose of producing assessable income, or carrying on a business for that purpose' (in this Ruling referred to for brevity as 'income producing or business purposes') than it is to the property's appearance, form, state or condition. In determining whether work done to property is a 'repair' in terms of subsection 53(1), it is therefore more significant to consider whether the work restores the efficiency of function of the property than it is to consider whether the appearance, form, state or condition of the property is exactly restored.

9. Work done partly to remedy or make good defects does not cease to be a repair if it is also done partly - even largely - in anticipation of forthcoming defects or in rectifying defects in their very early stages. Repairs are not limited to rectifying defects which have already become serious. Work done to premises, plant, etc that is not in need of repair, however, is not repair work and any expenditure for the work in these circumstances is not deductible under subsection 53(1).

10. Some kinds of maintenance work are 'repairs' in its context in subsection 53(1), for example, painting plant or business premises. Other kinds of maintenance work, such as oiling, brushing or cleaning something which is otherwise in good working condition and only requires attention to prevent the possibility of its going wrong in the future, are not 'repairs' in terms of subsection 53(1). Expenditure on the latter kind of maintenance work may be an allowable deduction under subsection 51(1).

11. What is 'repair' for the purposes of subsection 53(1) is a question of degree in each case having regard to the state of the particular premises, plant, etc at the time the expenditure is incurred and to the nature and extent of the work done.

12. If work done to premises, plant, etc goes beyond what is 'repairs' for the purpose of subsection 53(1) any expenditure for the work is not deductible for the reason that it is not 'repairs'. For example, the work may do more than restore the premises, plant, etc to its former state or condition - or do more than restore its efficiency of function - in which case it is not for 'repairs'.

13. Expenditure for 'repairs' is different from expenditure for 'manufacture'. Manufacturing operations involve more than work done on repair and result in the production of a new article. However, 'manufacture' does not extend to a process which results in the creation of a product that is not different in character or use from the article from which it is made but which is distinct only in terms of its marketability (eg a retreaded tyre). No deduction is allowable under subsection 53(1) for expenditure involved in manufacturing operations. Expenditure incurred in carrying on manufacturing operations is ordinarily an allowable deduction, however, under subsection 51(1).

Repair expenditure of a capital nature

(see explanations at paragraphs 50 to 57 and example at paragraph 99 of this Ruling)

14. Expenditure incurred for repairs is not deductible under subsection 53(1) if the expenditure is of a capital nature.

15. Expenditure for repairs to premises, plant, etc is of a capital nature if either:

(a) the guidelines for distinguishing between capital and revenue outgoings laid down by the courts in such cases as *Sun Newspapers Ltd v. FC of T* (1938) 61 CLR 337; 5 ATD 87 indicate that the expenditure is incurred in establishing, replacing or enlarging the profit-yielding (ie business) structure rather being a working or operating expense (see also paragraph 52 of this Ruling); or

(b) the expenditure, rather than be for work done to restore the premises, plant, etc by renewal or replacement of subsidiary parts of a whole, is for work that is a renewal in the sense of a reconstruction of the entirety (meaning by the entirety not necessarily the whole but substantially the whole of the premises, plant, etc under discussion). The application of this distinction depends very much on what, in the circumstances of the case, is properly considered to be the relevant entirety (see also paragraph 53 of this Ruling); or

(c) if premises, plant, etc bought for use as a capital asset in the buyer's business is not in good order and suitable for use in the way intended, expenditure incurred in putting it in order suitable for use is part of the cost of its acquisition and is of a capital nature (see also paragraphs 54 and 68 to 78 of this Ruling).

16. If work done goes beyond 'repair' and the whole cost is of a capital nature, no amount is allowed for 'notional' repairs, ie the amount which it is estimated that it would have cost the taxpayer if the premises, plant, etc had merely been repaired (but see paragraph 26 of this Ruling in relation to the deductibility of repairs carried out at the same time as an improvement).

17. The cost of replacing items such as stoves, refrigerators and furniture in premises used for income producing or business purposes is expenditure of a capital nature and is not deductible under subsection 53(1). [Note, however, that these items are plant on which depreciation is allowable].

18. The cost of replacing items such as locks and exhaust fans, which are permanent fixtures installed in premises used for income producing or business premises, is deductible as a repair under subsection 53(1) provided it is really a replacement of a worn out unit by a new unit of a similar design which simply restores efficiency of function and is not an improvement to the premises.

Distinction between repair and either renewal or reconstruction - what is meant by the 'entirety'

(see explanations at paragraphs 58 to 64 and examples at paragraphs 100 to 102 of this Ruling)

19. Repair is restoration by renewal or replacement of subsidiary parts of a whole. Renewal, as distinguished from repair, is reconstruction of the entirety. In this context, the 'entirety' does not mean only the whole but also includes substantially the whole subject-matter under discussion.

20. There is no one correct test for what is a subsidiary part and what is an entirety. Which approach to adopt depends on the facts in each particular case and, even then, the question is one of degree. To identify an entirety, it is helpful to consider whether:

- the premises, plant, etc under discussion is physically, commercially and functionally an inseparable part of something else;
- the premises, plant, etc is separately identifiable as a principal item of capital equipment;
- the thing or structure is an integral part, but only a part, of entire premises and is capable of providing a useful function without regard to any other part of the premises; and

- the thing or structure is a separate and distinct item of plant in itself from the thing or structure which it services or is an integral part of some larger item of plant.

21. Although the reconstruction of the whole of premises, plant, etc is not a deductible repair, a series of restorations could be undertaken over a period of time which progressively restore subsidiary parts of the whole. The progressive restoration would involve a series of deductible repair expenses. It is a question of fact and degree whether the work is the reconstruction of an entirety or a progressive restoration of subsidiary parts of the entirety over a period of time. Relevant considerations in drawing the line of demarcation here include:

- the nature of the premises, plant, etc involved;
- the period of time over which the work is done (the shorter the period the more likely a reconstruction of the entirety is involved); and
- whether or not the work is done in accordance with an on-going program of restoration.

Distinction between a repair and an improvement

(see explanations at paragraphs 65 to 67 and examples at paragraphs 103 to 114 of this Ruling)

22. The meaning of 'repair' is considered in paragraphs 6 to 13 above. In the case of a 'repair', broadly speaking, the work restores the efficiency of function of the property. An 'improvement', on the other hand, provides a greater efficiency of function in the property - usually in some existing function. It involves bringing a thing or structure (e.g. premises, plant, etc) into a more valuable or desirable state or condition than a mere repair would do. An improvement generally extends the income producing ability or expected life of the thing or structure. Replacement or substantial reconstruction of the entirety, as distinct from subsidiary parts of the whole, is an improvement.

23. If expenditure is incurred in replacing or renewing a part of premises, plant, etc with a material of a different type from the original, the work done may either repair the premises, plant, etc., or be an improvement to it.

24. Whether the use of a more modern material to replace the original material qualifies as a repair is a question that is determined on the facts of each case. It is restoration of efficiency of function rather than exact repetition of form or material that is significant. The test used is whether there is a sufficient degree of improvement to

justify the characterisation of the expenditure as capital and therefore exclude the expenditure from deductibility under subsection 53(1).

25. The material used does not have to be exactly the same as the original material for the work to be a repair. Similarly, the use of different material, whether it happens to be cheaper or more expensive than the original material being replaced, does not necessarily rule out the work from being a repair.

26. The character of a repair does not necessarily change because it is carried out at the same time as an improvement. If an extensive renovation or restoration project is undertaken combining repairs and improvements, it is necessary to examine separately the individual parts of the total project to determine whether any part, if considered in isolation from the entire project, is a repair. It is not appropriate to have regard only to the result of the entirety of the work done. It is inappropriate to regard the whole project as an affair of capital. In other words, if individual parts of the total project can be characterised as repairs, and if their cost can be reasonably quantified, those items are repairs. It must be possible to segregate the cost of the repairs actually effected from the capital cost of the improvements. Expenditure on 'notional' repairs is not deductible; see paragraph 16 of this Ruling.

Expenditure to remedy wear or damage in existence at the date of acquisition (initial repairs)

(see explanations at paragraphs 68 to 78 and examples at paragraphs 115 to 119 of this Ruling)

27. Expenditure incurred on initial repairs of newly or recently acquired premises, plant, etc, where the expenditure is incurred in remedying defects in existence at the date of acquisition, is expenditure of a capital nature and is not, therefore, deductible under subsection 53(1). It is not deductible even though the repairs are carried out shortly after the premises, plant, etc are acquired. The costs of effecting initial repairs are still not deductible even if some income happens to be earned before the repair expenditure is incurred.

28. The main consideration here is the condition of the premises, plant, etc when it is acquired. Whether at the time of acquisition the taxpayer was aware of the condition of the property, including its need for repair, and whether the purchase price reflected the need for repairs, are immaterial. We consider that the English Court of Appeal decision in *Odeon Associated Theatres v. Jones (Inspector of Taxes)* (1972) 1 All ER 681 is not authority in Australia for a contrary view. An initial repair expense is capital in nature. It is not the type of repair expenditure ordinarily incurred as a working expense in producing

assessable income or in carrying on a business. This is because it lacks a connection with the conduct or operations of the taxpayer that produce the taxpayer's assessable income. It is essentially an additional cost of acquiring the property. It is not deductible under subsection 53(1).

29. An initial repair expense may not be dissected or apportioned to allow a deduction of some part of the expense that may be said to remedy defects arising from the use of the premises, plant, etc by the taxpayer after it was acquired. Subsection 53(3) does not provide for any such dissection or apportionment.

Expenditure incurred by a taxpayer on repairs to property that the taxpayer does not own.

(see explanations at paragraph 79 and examples at paragraphs 120 to 121 of this Ruling)

30. A taxpayer is entitled to a deduction under subsection 53(1) for repairs to premises, plant, etc he or she holds, occupies or uses in a year of income for income producing or business purposes, even though the taxpayer does not own that property. Similarly, there need be no legal obligation on the taxpayer to undertake the repairs for the taxpayer to be entitled to a deduction. Expenditure for the repairs must be 'incurred' by the taxpayer in the year of income in which the deduction is claimed. Payment for the repairs in the income year is not necessary (though this will of course be expenditure incurred) but the expenditure must have been 'incurred' in that year. The word 'incurred' in subsection 53(1) has the same meaning as the word 'incurred' used in subsection 51(1). Broadly stated, to be 'incurred' there needs to be an existing pecuniary obligation in relation to the repairs that has become due, but not necessarily payable, at that time.

Expenditure for repairs before premises, plant, etc is held, occupied or used for income producing or business purposes.

(see explanations at paragraphs 80 to 83 and example at paragraph 122 of this Ruling)

31. Expenditure for repairs incurred in a year of income before the premises, plant, etc is held, occupied or used for income producing or business purposes is not deductible under subsection 53(1).

Expenditure for repairs after premises, plant, etc ceases to be held, occupied or used for income producing or business purposes.

(see explanations at paragraphs 84 to 88 and examples at paragraphs 123 to 124 of this Ruling)

32. The cost of repairs carried out after premises, plant, etc has ceased to be held, occupied or used for income producing or business purposes is an allowable deduction under subsection 53(1) provided:

(a) the necessity for the repair can be related to the period during which the premises, plant, etc was producing assessable income; and

(b) the premises, plant, etc has been held, occupied or used to produce assessable income, or in carrying on a business for that purpose, at some time during the year of income in which the expenditure is incurred.

Expenditure for repairs to premises, plant, etc previously used for non-income producing purposes.

(see explanations at paragraphs 89 to 93 and examples at paragraphs 125 to 127 of this Ruling)

33. In appropriate circumstances, expenditure for repairs can qualify as a deduction where the relevant premises, plant, etc has previously been used for non-income producing purposes.

34. Where expenditure for repairs is incurred in a year of income in which the premises, plant, etc is used for income producing or business purposes, and not by way of effecting initial repairs, the expenditure is deductible under subsection 53(1) if the need for the expenditure arises from use of the premises, plant, etc while it is being applied to income producing or business purposes.

Expenditure for repairs to premises, plant, etc used only partly for income producing purposes during a year of income.

(see explanations at paragraphs 94 to 96 and example at paragraph 128 of this Ruling)

35. If premises, plant, etc is used during a period partly for income producing or business purposes and partly for non-income producing or non-business purposes, expenditure for repairs is only deductible to the extent that we consider reasonable. As with all discretions, we must decide each case on its merits. However, we would expect that the amount of the expenditure allowable under subsection 53(1), when read with subsection 53(3), would ordinarily be the amount

attributable to the use of the premises, plant, etc during the period for income producing or business purposes.

Date of effect

36. This Ruling applies to years commencing both before and after its date of issue. 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 (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Explanations

Meaning of the word 'repairs'

(see ruling at paragraphs 6 to 13 and examples at paragraphs 97 to 98 of this Ruling)

37. The word 'repairs' in subsection 53(1) is not defined in the Act. In its context in subsection 53(1), the word 'repairs' bears its ordinary meaning. According to *The Shorter Oxford English Dictionary*, 'repair' means:

> 'Restoration of some material thing or structure by the renewal of decayed or worn-out parts, by refixing what has become loose or detached; the result of this.'

38. Many judicial decisions make it plain that 'repair' involves the making good of defects, including the renewal of parts and that the word does not imply a total reconstruction: *Stroud's Judicial Dictionary*. Repair, as the word is commonly understood, does not depend on whether much is done or only a little. Lord Macnaghten said in the House of Lords decision in *Hoddinott v. Newton Chambers & Co Ltd* [1901] AC 49 at 54:

> 'A man does not usually wait to repair his house until it is altogether ruinous and on the point of falling to pieces'.

39. The High Court of Australia (Windeyer J) said in *W Thomas & Co Pty Ltd v. FC of T* (1965) 115 CLR 58 at 72; 14 ATD 78 at 87:

> 'The words "repair" and "improvement" may for some purposes connote contrasting concepts; but obviously repairing a thing improves the condition it was in immediately before repair. It may sometimes be convenient for some purposes to contrast a "repair" with a "replacement" or a "renewal". But repairs to a whole are often made by the replacement of worn-out parts by

> new parts. Repair involves restoration of a thing to a condition it formerly had without changing its character. But **in the case of a thing considered from the point of view of its use as distinct from its appearance**, it is restoration of efficiency of function rather than exact repetition of form or material that is significant. Whether or not work done upon a thing is aptly described as a repair of that thing is thus a question of fact and degree'. (Emphasis added.)

40. The word 'repairs', in its context in subsection 53(1), is more directed to the holding, occupying or use of property for income producing or business purposes than it is to the property's appearance, form, state or condition. As Windeyer J indicated in the italicised passage above from the *W Thomas & Co* case, it is therefore more significant to consider whether the work restores the efficiency of function of the property than it is to consider whether the appearance, form, state or condition of the property is exactly restored.

41. Maintenance, as generally understood, includes the prevention of defects, a common example being the regular re-painting of business premises. The word 'maintenance' is not necessarily distinguished from 'repair'. It may in some contexts be the same as 'repair', and it may in some contexts have a wider meaning which includes repairing as well as other operations. Some kinds of maintenance work constitute 'repairs' in its context in subsection 53(1) for example, painting plant or business premises.

42. In *Day v. Harland and Wolff* [1953] 2 All ER 387 Pearson J observed at 388:

> 'So, very broadly speaking, I think that to repair is to remedy defects, but it can also properly include **an element** of the "stitch in time which saves nine". Work does not cease to be repair work because it is done **to a large extent** in anticipation of forthcoming defects or in rectification of merely incipient defects, rather than the rectification of defects which have already become serious. **Some** element of anticipation is included'.(Emphasis added.)

43. His Honour's statement, by necessary implication, indicates that work done that is **only** in anticipation of forthcoming defects does in fact cease to be repair work.

44. Expenditure incurred on work done to premises, plant, etc, if the work goes beyond remedial or restorative work that is a repair, is not deductible for the reason that the expenditure is not for 'repairs' within the meaning of that term in subsection 53(1).

45. Oiling, brushing or cleaning something which is otherwise in good working condition, and only requires attention to prevent the

possibility of its going wrong in the future, is not 'repairs' in terms of subsection 53(1): compare *London & North-Eastern Railway Co v. Berriman* [1946] 1 All ER 255 at 267 [The cost of these operations may be deductible under subsection 51(1)].

46. What is a 'repair' for the purposes of subsection 53(1) is a question of degree in each case having regard to the state of the particular premises, plant, etc at the time the expenditure is incurred (per Buckley LJ in *Lurcott v. Wakely & Wheeler* [1911] 1 KB 905 at 924) and to the nature and extent of the work done. 'Repair' may involve renewal or replacement to some degree.

47. 'Repair' differs from 'manufacture'. Repair replaces or corrects worn out or dilapidated parts of plant, machinery, implements, utensils, rolling stock or articles and contemplates the continued existence of the plant, etc. The essence of manufacture is that what is made is a different thing from that out of which it is made. However, 'manufacture' does not extend to a process which results in the creation of a product that is not different in character or use from the article from which it is made but which is distinct only in terms of its marketability (e.g. a retreaded tyre which, in terms of its marketability, is distinct from either a new tyre or a worn tyre but which is not different in character or use from the worn tyre that was submitted to the retreading process): *FC of T v. Jax Tyres Pty Ltd* 85 ATC 4001; (1984) 16 ATR 97.

48. The recharging of batteries, for instance, can fairly be described as a repair. But if batteries are completely dismantled and each internal compartment is completely rebuilt with new plates, these replating operations result in the manufacture of batteries that have lost their original identities: *FC of T v. Adams* (1948) 8 ATD 332 at 334. Similarly, operations to remodel fur garments involving the taking of skins made up into one description of fur garment and producing another so alters an existing fur garment to produce a new one. A different article is made. The work constitutes manufacture and not 'repair': *FC of T v. Jack Zinader Pty Ltd* (1949) 78 CLR 336; 9 ATD 46.

49. No deduction is allowable under subsection 53(1) for expenditure involved in manufacturing operations. A deduction for the costs of these manufacturing operations is ordinarily allowable, however, under subsection 51(1).

Repair expenditure of a capital nature

(see ruling at paragraphs 14 to 18 and example at paragraph 99 of this Ruling)

50. Subsection 53(1) excludes from being a deduction 'expenditure of a capital nature'.

51. Two of the leading Australian cases on determining whether expenditure for repairs is of a capital nature are *FC of T v. Western Suburbs Cinemas Ltd* (1952) 86 CLR 102; 9 ATD 452 and *Lindsay v. FC of T* (1960) 106 CLR 377; 12 ATD 197 (affirmed on appeal at (1961) 106 CLR 377; 12 ATD 505).

52. In the *Western Suburbs Cinemas case*, the High Court (Kitto J) held that a new ceiling was an improvement to a fixed capital asset and that its cost was a capital charge. His Honour said at (86 CLR) 105-6; (9 ATD) 454:

> 'To decide whether a particular item of expenditure on business premises ought to be charged to capital or revenue account is apt to be a matter of difficulty, though the difference between the two accounts is clear enough as a matter of general statement: *Sun Newspapers Ltd v. FC of T*. In this case, the work done consisted of the replacement of the entire ceiling, a major and important part of the structure of the theatre, with a new and better ceiling. The operation seems to me different, not only in degree, but in kind, from the type of repairs which are properly allowed for in the working expenses of a theatre business. It did much more than meet a need for restoration; it provided a ceiling having considerable advantages over the old one, including the advantage that it reduced the likelihood of repair bills in the future.'

53. In *Lindsay's* case, the High Court (Kitto J) held that expenditure incurred to renew a slipway was a renewal of an entirety and not a deductible repair. His Honour said at (106 CLR) 383-4; (12 ATD) 200:

> 'If the work done in respect of the slipway is correctly described as repairs, it cannot, I think, on the facts of this case, be of a capital nature. The problem is to characterise the expenditure according to the familiar distinction between repair, in the sense of restoration by renewal or replacement of subsidiary parts of a whole, and renewal in the sense of reconstruction of the entirety, meaning by the entirety not necessarily the whole but substantially the whole of the subject-matter under discussion: per Buckley LJ, in *Lurcott v. Wakely & Wheeler*; *Rhodesia Railways Ltd v. Resident Commissioner and Treasurer, Bechuanaland Protectorate*'.

54. Expenditure on initial repairs of newly or recently acquired premises, plant, etc where the expenditure is incurred in remedying defects in existence at the date of acquisition is of a capital nature and

is not, therefore, deductible (paragraphs 68 to 78 of this Ruling elaborate on initial repairs).

55. No deduction is allowable for 'notional' repairs, ie an amount which it is estimated the repair would have cost the taxpayer if the premises, plant, etc had in fact been repaired.

56. In the *Western Suburbs Cinemas Ltd case* the ceiling of a motion picture theatre was in a state of disrepair. To restore the ceiling to its original condition would have cost £603. The company instead replaced the ceiling with a new one of a different design and better material for a cost of more than £3000. The High Court (Kitto J) concluded that the new ceiling was an improvement to a fixed capital asset and that its cost was a capital charge. After reaching this conclusion, his Honour rejected an argument that, where an actual expenditure is not an allowable deduction, a notional expenditure may be. Kitto J said at (CLR) 107; (ATD) 455:

> '....when a taxpayer has two courses open to him, one involving an expenditure which will be an allowable deduction for income tax and the other involving an expenditure which will not be an allowable deduction, and for his own reasons he chooses the second course, he cannot have his income tax assessed as if he had exercised his choice in the opposite way. Section 53 is concerned with expenditure which was in fact incurred, not with expenditure which could have been incurred but was not'.

57. Costs of replacing items such as locks and exhaust fans installed as permanent fixtures in premises used for income producing or business premises, are deductible under subsection 53(1) as repairs provided:

(a) a worn out unit is really replaced by a new unit of a similar design which simply restores efficiency of function; and

(b) it is not an improvement to the premises: 17 TBRD Case S 27; 13 CTBR (NS) Case 56.

Distinction between repair and either renewal or reconstruction - what is meant by the 'entirety'

> (see ruling at paragraphs 19 to 21 and examples at paragraphs 100 to 102 of this Ruling)

58. Repairs to premises, plant, etc may involve renewal or replacement of a subordinate part of the premises, plant etc. As Buckley LJ said in *Lurcott v Wakely & Wheeler* [1911] 1 KB at 924:

> 'Repair is restoration by renewal or replacement of subsidiary parts of a whole. Renewal, as distinguished from repair, is

> reconstruction of the entirety, meaning by the entirety not necessarily the whole but substantially the whole subject-matter under discussion...the question of repair is in every case one of degree, and the test is whether the act to be done is one which in substance is the renewal or replacement of defective parts, or the renewal or replacement of substantially the whole'.

59. Renewal, replacement or reconstruction of the entirety (ie the whole or substantially the whole) of a thing or structure is an improvement rather than a deductible repair.

60. The tests used by the courts and tribunals, or suggested by commentators, to identify an entirety - as distinct from a subsidiary part - include:

- Are the premises, plant, etc (eg chimney) physically, commercially and functionally an inseparable part of an entirety (eg factory)?: *Samuel Jones & Co (Devondale) Ltd v. IRC* (1952) 32 TC 513.
- Are the premises, plant, etc (eg slipway) separately identifiable as a principal item of capital equipment?: *Lindsay's case*.
- Is the thing or structure (e.g. timber staircases) an integral part, but only a part, of the entire premises and is it capable of providing a useful function without regard to any other part of the premises?: Case W68, 89 ATC 613; AAT Case 5232 (1989) 20 ATR 3796.
- Is the thing or structure (e.g. meters and pumping plant) a separate and distinct item of plant in itself from the thing or structure (e.g. light and power station) to which it supplied something (e.g. electric light and power) or an integral part of some larger item of plant?: Case 36, (1949) 15 TBRD 287.
- Are the premises, plant, etc., a 'unit of property' as that expression is used in the depreciation provisions of the income tax law - bearing in mind that, to be such a 'unit' the thing or structure must be 'functionally separate and independent'?: *Ready Mixed Concrete (Victoria) Pty Ltd v. FC of T* (1969) 118 CLR 177; 15 ATD 215.

61. The leading Australian case in this area is the High Court decision in *Lindsay's case* where slip proprietors and ship repairers reconstructed one of two slipways. The taxpayer submitted that the relevant entirety was the whole of the business premises on which the slipway existed or, alternatively, the whole of the slip (comprising the slipway, the hauling machinery which served it, the cradle on it and the dolphins and warping winches by which vessels were manoeuvred

on to it). Kitto J rejected a submission that the slipway was only a subsidiary part of some larger thing or aggregation of things. His Honour held that the expenditure involved was not deductible under section 53 because the slipway ought to be considered as an entirety by itself (106 CLR at 385; 12 ATD at 201):

> 'It is separately identifiable as a principal, and indeed principal, item of capital equipment, so that in a discussion as to whether work done in relation to it constitutes a repair or a renewal in the opposed senses above mentioned, the subject-matter in relation to which the choice of description is to be made is the slipway itself, and not any larger thing or aggregation of things of which it might be suggested to form part'.

62. In the *W Thomas & Co case*, where the High Court considered deductions claimed for repairs to guttering, the roof, walls and two floors of a building, the view was taken that the whole building was the entirety. Windeyer J said (115 CLR at 66; 14 ATD at 83) that the relevant question is not:

> 'whether the roof or the floor or some other part of the building, looked at by itself, was repaired as distinct from being reconstructed or replaced. It is whether what was done to the roof or the floor or some other part was a repair to the building'.

63. In other examples, the floor of a house (*Lister v. Lane* [1893] 2 QB 212) and the front external wall of a house (*Lurcott v Wakely & Wheeler*) have each been held to be a subsidiary part of the whole.

64. It is a question of fact and degree whether a reconstruction is undertaken of the whole of premises, plant, etc or a series of restorations is embarked on over a period of time, progressively restoring subsidiary parts of the whole. In *Lindsay's* case the expenditure on the slipway was regarded as a non-deductible expense for the reconstruction of an entirety. The expenditure would remain non-deductible if it was simply dissected into parts referable to different sections of the slipway.

Distinction between a repair and an improvement

> (see ruling at paragraphs 22 to 26 and examples at paragraphs 103 to 104 of this Ruling)

65. An important question in distinguishing between a repair and an improvement is whether expenditure incurred in replacing or renewing a part of premises, plant, etc with a material of a different type from the original is a repair of the premises, plant, etc or an improvement to it.

66. It needs to be borne in mind that repairing a thing improves the condition it was in immediately before repair. Whether the use of a more modern material to replace the original material qualifies as a repair is a question that is determined on the facts of each case.

67. Relevant considerations, consistently with the approach taken by the High Court in the *Western Suburbs Cinemas* case, are:

(a) whether or not the thing replaced or renewed was a major and important part of the structure of the premises, plant, etc;

(b) whether the work done did more than meet the need for restoration of efficiency of function;

(c) whether the thing was replaced with a new and better one; and

(d) whether the new thing has considerable advantages over the old one, including the advantage that it reduces the likelihood of repair bills in the future.

Expenditure to remedy wear or damage in existence at the date of acquisition (initial repairs)

(see ruling at paragraphs 27 to 29 and examples at paragraphs 115 to 119 of this Ruling)

68. A repair after acquisition of property is an 'initial repair' if repair was 'due' when the property was acquired, in the sense that there was a need for repair to restore or maintain the property's efficiency of function. In other words, the property was neither in good order when it was acquired nor suitable for use in the way intended.

69. The leading Australian case in this area is the High Court decision in *W Thomas & Co Pty Ltd v. FC of T*(1965) 115 CLR 58; 14 ATD 78. There, Windeyer J held that roof, guttering, wall, basement floor and wooden floor repairs and painting of a building in the year of income it was acquired was expenditure of a capital nature.

70. His Honour said (115 CLR at 72-3; 14 ATD at 87):

'Expenditure upon repairs is properly attributable to revenue account when the repairs are for the maintenance of an income-producing capital asset. Maintenance involves the periodic repair of defects that are the result of normal wear and tear in operation. **It is an expense of a revenue nature when it is to repair defects arising from the operations of the person who incurs it**. But if when a thing is bought for use as a capital asset in the buyer's business it is not in good order and suitable for use in the way intended, the cost of putting it in order suitable for

> use is part of the cost of its acquisition, not a cost of its maintenance. The decision of the Court of Sessions in *Law Shipping Co Ltd v. Inland Revenue Commissioners* (1923) 12 TC 621 is commonly cited as authority for that proposition. The principle is obvious without the need for any supporting authority'. (Emphasis added.)

71. His Honour made it clear that it is immaterial whether the taxpayer knew of the defects or whether the purchase price was affected by them. Windeyer J said (115 CLR at 74; 14 ATD at 88):

> 'It seems to me immaterial that when the taxpayer acquired the building it did not know of some of its defects...That means only that the cost of obtaining an asset suitable for its purpose was greater than had been expected'.

72. In the *Law Shipping Co* case, the taxpayer in December 1919 bought for £97,000 a steamship ready to sail and with freight booked and loaded. As the periodical Lloyd's survey was then considerably overdue, an exemption from survey had been obtained for the voyage about to commence. On return from the voyage in May 1920, the ship underwent survey and the taxpayer had to spend over £50,000 on repairs. The Special Commissioners allowed a deduction of only £12,000 as being applicable to the period during which the taxpayer was the owner of the ship. The Court of Session, Scotland (First Division) held that the amount disallowed was of a capital nature and not deductible.

73. More recently, the English Court of Appeal in *Odeon Associated Theatres v. Jones (Inspector of Taxes)* (1972) 1 All ER 681 held that expenditure incurred on a number of theatres acquired in a somewhat run-down condition during the Second World War and the post-war years (in respect of dilapidations which occurred before acquisition) was expenditure of a revenue character.

74. A key reason for the English Court of Appeal holding that the expenditure on repairs was not of a capital nature was that the purchase price was not affected by the fact that the cinema was in disrepair at the date it was acquired. The reason that the purchase price was not affected was that there was a war-time prohibition on repairing cinemas, causing all cinemas to be in a similarly dilapidated condition.

75. Even if the *Odeon Theatres* case is authority in the United Kingdom for the proposition that expenditure on initial repairs is not of a capital nature where the asset's state of disrepair did not affect its purchase price, we consider that it is not authority for that proposition in Australia. Such a proposition would, in our view, be inconsistent with the binding High Court of Australia authority of the *W Thomas &*

Co case: see Case D 47, 72 ATC 272 per AM Donovan (Chairman) and RK Todd (Member) at 291; Case 14 (1972) 18 CTBR (NS) 82 at 102-3 and Case V 83, 88 ATC 580 per DJ Trowse (Member) at 583; AAT Case 4371 (1988) 19 ATR 3540 at 3542-3.

76. In essence, therefore, expenditure for repairs to newly or recently acquired premises, plant, etc is deductible only if it involves the remedying of defects attributable to the period in which the premises, plant, etc is held, occupied or used by the taxpayer for income producing or business purposes. If, on the other hand, the expenditure involves putting the premises, plant, etc in order suitable for use or the cost of remedying defects in it existing at the time of purchase, it is of a capital nature and not deductible under subsection 53(1).

77. Initial repair expenses may not be dissected or apportioned to allow a deduction to the extent to which the repair work remedies defects arising from use of premises, plant, etc by the taxpayer after it is acquired. Windeyer J made this clear in the *W Thomas & Co case*, saying (115 CLR at 74; 14 ATD at 88):

> 'It may be too that the need for some of the work done on the building in the second half of 1961 was contributed to by the use that the taxpayer had made of it during the first half of that year. But I can see no basis for apportioning between capital and revenue the actual expenditure that was incurred on any of the items listed in the statement'.

78. The proposition that initial repairs are of a capital nature is not some unique principle. Rather, it is a particular application of the general tests set out by Dixon J in *Sun Newspapers Ltd v. FC of T* (1938) 61 CLR 337; 5 ATD 87 for determining what is capital expenditure. Under these tests, expenditure relating to the establishment, replacement or enlargement of the profit-yielding structure, as opposed to expenditure incurred in the operation of that structure, is of a capital nature: see Case P 5, (1963) 14 TBRD 14 at 25; Case 44 (1963) 11 CTBR (NS) 207 per RE O'Neill (Member) at 218-9; Case R 101, 84 ATC 673 per TJ McCarthy (Member) at 675; Case 154 (1984) 27 CTBR (NS) 1206 at 1209 and Case V 83, 88 ATC 580 per DJ Trowse (Member) at 583; AAT Case 4371 (1988) 19 ATR 3540 at 3542-3.

Expenditure incurred by a taxpayer on repairs to property that the taxpayer does not own

> (see ruling at paragraph 30 and examples at paragraphs 120 to 121 of this Ruling)

79. Entitlement to a deduction under subsection 53(1) for repairs to premises, plant, etc depends on a taxpayer having held, occupied or

used it in a year of income for income producing or business purposes. It is not a specific requirement of subsection 53(1), unlike subsection 54(1), that the premises, plant, etc be owned by the taxpayer. It is a requirement of subsection 53(1), however, that the expenditure for repairs be 'incurred' in the year of income that it is claimed as a deduction. For this purpose, the word 'incurred' in subsection 53(1) has the same meaning given to it as that given by the courts to the same word in subsection 51(1): (1965) 15 TBRD Case Q 48.

Expenditure for repairs before premises, plant, etc is held, occupied or used for income producing or business purposes

(see ruling at paragraph 31 and example at paragraph 122 of this Ruling)

80. Under subsection 53(1), expenditure by a taxpayer for repairs qualifies for deduction, in our view, if, when the expenditure is incurred in the year of income, the premises, plant, etc had been held, occupied or used by the taxpayer for the purpose of producing assessable income or in carrying on a business for that purpose.

81. Subsection 53(1) requires, in our view, that, when expenditure is incurred by a taxpayer for repairs in a relevant year of income:

(a) the premises, plant, etc be (or have been) held at some stage of the year of income in which the repair expenditure is incurred; and

(b) the holding, occupying or use of the premises, plant, etc in the relevant year of income (for the required purpose) be either before or when the expenditure for repairs is incurred.

82. Expenditure for repairs incurred in a year of income before premises, plant, etc is held, occupied or used in the year of income for income producing or business purposes is not deductible under subsection 53(1) for various reasons:

(a) the expenditure in these circumstances does not satisfy the affirmative requirements of subsection 53(1);

(b) the expenditure in these circumstances is an expense to prepare the premises, plant, etc for income producing or business; and

(c) the expenditure is, in any event, of a capital nature.

83. As the Administrative Appeals Tribunal (Mr PM Roach, Senior Member) said in Case V 167, 88 ATC 1107 at 1111; AAT Case 12 (1986) 18 ATR 3056 at 3059:

'If a taxpayer buys a property with the view to letting it at a rent and immediately paints it throughout before letting it, the expenditure may be fairly characterised as capital...'

Expenditure for repairs after premises, plant, etc ceases to be held, occupied or used for income producing or business purposes.

(see ruling at paragraph 32 and examples at paragraphs 123 to 124 of this Ruling)

84. Repairs are commonly effected to business or rent producing premises in contemplation of sale or of use of the premises by the taxpayer as a residence. If a repair is made to premises, plant, etc after the cessation of a taxpayer's income producing or business activities, subsection 53(1) allows a deduction for the costs provided:

(a) the necessity for the repair can be related to the period during which the premises, plant, etc was producing assessable income; and

(b) the premises, plant, etc had been used to produce assessable income, or in carrying on a business for that purpose, at some time during the year of income in which the expenditure is incurred.

85. We respectfully disagree with the decision of Taxation Board of Review No 1 in Case M 2, 12 TBRD 4 where:

(a) the taxpayer in the 1958-59 year of income incurred expenses repairing fences and painting a house which he had rented to tenants for 23 years but which he intended to sell;

(b) the renovations were done after the tenant vacated the house in October 1958; and

(c) the Board held that no deduction was allowable because the house, when the repairs were effected, was not held for the purpose of producing income.

86. We respectfully agree, however, with the decision of Taxation Board of Review No 3 in Case M 33, 12 TBRD 187 where the Board disallowed a deduction claimed for repairs carried out after the property ceased to be rent producing and the expenditure was incurred in a later year of income.

87. As stated at paragraph 81 of this Ruling, in our view, subsection 53(1) requires that:

(a) the premises, plant, etc be (or have been) held at some stage of the year of income in which the repair expenditure is incurred; and

(b) the holding, occupying or use of the premises, plant, etc in the relevant year of income be either before or at the same time as the expenditure for repairs is incurred.

88. It is not a specific requirement of subsection 53(1) that the expenditure for repairs be incurred while the premises, plant, etc are being held, occupied or used for the required purpose (but, of course, expenditure in that situation, all other requirements being satisfied, is deductible). It is sufficient if, when the expenditure for repairs is incurred in a year of income, the premises, plant, etc have been held, occupied or used in the year of income for the required purpose. It is not sufficient if, when the expenditure for repairs is incurred in a year of income, the premises, plant, etc are not held, occupied or used at all in that year of income for the required purpose (even if the premises, plant, etc had been held, occupied or used in prior years for that purpose).

Expenditure for repairs to premises, plant, etc previously used for non-income producing purposes

(see ruling at paragraphs 33 to 34 and examples at paragraphs 125 to 127 of this Ruling)

89. Expenditure may be incurred by a taxpayer for repairs to premises, plant, etc which, whether or not it was owned by the taxpayer in earlier years, was not held, occupied or used in those years for income producing or business purposes. The decision of the Administrative Appeals Tribunal in Case V 167, 88 ATC 1107; AAT Case 12 (1986) 18 ATR 3056 makes it clear that, in appropriate circumstances, expenditure for repairs to premises, plant etc can qualify as a deduction where it has previously been used for non-income producing purposes.

90. There, a house had been occupied by the taxpayer's parents until 1977. In that year the property was transferred to the taxpayer and his wife who let the house to tenants. During 1982 the property was unoccupied while the roof, spouting, a window and kitchen cupboards were replaced and the house was rewired.

91. The AAT, having determined that the work done some five years after its acquisition did not constitute improvements or 'initial repairs', proceeded to consider an argument for the Commissioner that the deterioration which needed to be remedied in 1982 was attributable to all years since the construction of the house in the 1950s. Mr PM

Roach, Senior Member, rejected this argument. He said (88 ATC at 1111; 18 ATR at 3059):

> 'A matter of repair is proper to revenue account if the need for the expenditure arises out of its use while the property is being applied to income-producing purposes.'

92. In Case W 7, 89 ATC 161; AAT Case 4845 (1988) 20 ATR 3170, Mr Roach commented on Case V 167; Case 12, saying (89 ATC at 170; 20 ATR at 3180):

> 'The point in [that case] was that, where an expense of repair is incurred "in the course of" income-producing activity and not by way of remedying "initial defects" or effecting "initial repairs", the entitlement to a deduction is not to be lost only because what occasions the need for the repair is deterioration; and that that deterioration is attributable to a period prior to the acquisition of the property by the taxpayer.'

93. We respectfully accept the correctness of these views. If premises, plant, etc is used wholly for the production of assessable income during an income year in which expenditure for repairs is incurred, the total cost of repairs is deductible (provided of course that the expenditure is not of a capital nature). Provided the repair expenditure is not for initial repairs, a deduction is allowable, even though some of the deterioration or damage giving rise to the repairs is attributable to use of the premises, plant, etc by the taxpayer before its use for the purpose of business or producing assessable income.

Expenditure for repairs to premises, plant, etc used only partly for income producing purposes during a year of income

> (see ruling at paragraph 35 and example at paragraph 128 of this Ruling)

94. Expenditure on repairs incurred before 19 April 1984 was deductible in full so long as the property was used during the year of income to some extent for income producing or business purposes: see Case Q11, 83 ATC 41; 26 CTBR (NS) Case 75 and Case Q98, 83 ATC 487; 27 CTBR (NS) Case 26.

95. Subsection 53(3) was inserted to overcome this result. By subsection 53(3), expenditure (incurred on or after 19 April 1984) for repairs to premises, plant, etc used in a year of income in part for income producing or business purposes is deductible only to the extent that we consider reasonable. According to the explanatory memorandum accompanying Income Tax Assessment Amendment Bill (No 3) 1984, subsection 53(3) means that expenditure for repairs

attributable to private or domestic use, or to earning exempt income, is not allowable.

96. Subsection 53(3) allows an apportionment of expenditure incurred by a taxpayer in a year of income for repairs to premises, plant, etc used partly in that year for income producing or business purposes and partly for non-income producing or non-business purposes. The amount of the expenditure allowable will ordinarily be the amount attributable to the use of the premises, plant, etc in the year of income for income producing or business purposes.

Examples

Meaning of the word 'repairs'

(see ruling at paragraphs 6 to 13 and explanations at paragraphs 37 to 49 of this Ruling)

Example 1

97. Sam Tabernarius, a shopkeeper, decides to replace the awning of his shop with a more modern and aesthetic equivalent. The awning is in good repair before the work is done, there is nothing to be restored, nothing detached or to be fixed. The expenditure involved is not for repairs and no deduction is allowable under subsection 53(1).

Example 2

98. Samantha Pellio carries on business as a furrier and remodels fur garments to form fur coats, stoles, capes and collars. The operations involve taking skins made up into one description of fur garment and producing another. Samantha so alters an existing fur garment to produce a new one. She has made a different article. The work constitutes manufacture and not 'repair'. No deduction is allowable under subsection 53(1) for expenditure involved in the operations. Samantha is entitled to a deduction under subsection 51(1) for her manufacturing costs.

Repair expenditure of a capital nature

(see ruling at paragraphs 14 to 18 and explanations at paragraphs 50 to 57 of this Ruling)

Example 3

99. Elle uses her truck for income producing purposes. She replaces the truck's worn out engine with one of a greater capacity. The costs relate to an improvement because the replacement involved a significantly greater efficiency in function in the engine. The costs are

not deductible under subsection 53(1). A deduction for depreciation under subsection 54(1) may be allowable.

Distinction between repair and either renewal or reconstruction - what constitutes the 'entirety'

(see ruling at paragraphs 19 to 21 and explanations at paragraphs 58 to 64 of this Ruling)

Example 4

100. Mr Fermier and Mr Agricola are neighbouring farmers affected by a severe bushfire. Mr Fermier restores his existing fencing to good condition by mending it and replacing damaged sections. However, Mr Agricola replaces his fencing in its entirety.

101. Mr Fermier is entitled to claim a deduction for the cost of repairing his fencing under subsection 53(1). However, Mr Agricola's expenditure is not deductible under subsection 53(1) because the whole of the fencing was replaced, making it a reconstruction of the entirety.

Example 5

102. Leo has used his motor cycle for many years for income producing purposes. He replaces its worn out engine with its modern equivalent. The motor cycle is the entirety, rather than the engine. Leo has replaced only a functional part of the entirety, not the entirety itself. The new engine restores the motor cycle to its former condition and efficiency of function without changing its character. The costs are deductible under subsection 53(1).

Distinction between a repair and an improvement

Material used different from original material

(see ruling at paragraphs 23 to 25 and explanations at paragraphs 65 to 66 of this Ruling)

Example 6

103. Mary Fabrica owns a factory in which the bitumen floor laid on a gravel base needs repairing. She replaces it with a new floor consisting of an underlay of concrete topped with granolith (a paving stone of crushed granite and cement). The new floor, from a use (rather than an appearance) point of view, is not superior in quality to the old floor. The new floor performs precisely the same function as the old and is no more satisfactory. In fact, the new floor is more expensive to repair than the old. Because the new floor is not a

substantial improvement, it is a repair and its cost is deductible under subsection 53(1): Case T 75, 18 TBRD 377; 14 CTBR (NS) Case 40.

Example 7

104. Joe Merces owns a two-storey rent producing property consisting of shops and flats. The external walls of the upper storey are made of weatherboard and one wall has several rotting boards. Joe replaces the rotting weatherboards. Instead of painting the new weatherboards, Joe covers the wall with cladding which was reputed to require no future maintenance. The cladding does not essentially change the form or efficiency of function of the wall. The expense of replacing the rotting weatherboards and then covering the wall with cladding in this situation is a repair and is deductible under subsection 53(1): Case R 102, 84 ATC 676; 27 CTBR (NS) Case 156.

105. However, if there had been no rotting weatherboards or other incipient defects, and the cladding work was solely directed at eliminating future maintenance, the work would not be a repair.

Example 8

106. Sarah Tonsor owns the property from which she runs her hairdressing business. The front wall is cracked and dangerous as a result of the foundations moving. She replaces the brick wall with a monolithic concrete wall reinforced with steel rods and erected on wide concrete rafts. The new wall differs in design from the old one and is a substantial improvement over the old wall in that it is stronger and less liable to be damaged by shifts in the foundations. The new wall also gives much more window space on both upper and ground floors as well as presenting a more modern appearance. The architect admits that the new wall has much greater strength than the old wall and is an improvement on it. The expenditure is on an improvement and is not deductible under subsection 53(1): (1956) Case G 61, 7 TBRD 342; 6 CTBR (NS) Case 56.

Example 9

107. Raj has owned a rental property for some years where asbestos has been used for fire rating and insulation purposes. He becomes aware of the possible health risks associated with the presence of asbestos in buildings. Raj decides to take action to control the health risks. The work involved in controlling health risks associated with the use of asbestos in income producing properties (for example, by enclosing the asbestos material, by encapsulating or sealing the asbestos material to prevent the release of asbestos fibres or by removing the asbestos material altogether) qualifies as a repair. This is so whether the work is necessary to control health risks actually existing or whether, as a preventative measure, to treat the asbestos to prevent health risks occurring in the future. Expenditure on these

measures is deductible if it otherwise meets the requirements of subsection 53(1). If Raj had just purchased the property with an existing asbestos health risk problem, expenditure to control the problem would be of a capital nature. [Similarly, if it was necessary to remove asbestos before the demolition of a building or as part of a major alteration to the building, the costs of removal would be part of the costs of demolition or alteration respectively and would be of a capital nature.]

108. Comparable taxation treatment would apply to the controlling of health risks associated with other comparably dangerous substances such as, among other things, chlorofluorocarbons, chromium, dioxin, cyanide, pesticides and arsenic.

Example 10

109. Ismael Piscator uses his fishing trawler for income producing purposes. He replaces the trawler's worn out engine with its modern equivalent, returning the trawler to its former efficiency of function without changing its character. The costs are deductible.

Repairs and improvements effected concurrently

(see ruling at paragraph 26 of this Ruling)

Example 11

110. Tracey owns a factory. The council has advised her to repair faulty wiring, to reposition existing electrical outlets and to install new power points, mains and switchboards. Only part of the expenditure is incurred on repair work. Individual parts of the work done are capable of being classified as repairs, if examined in isolation from the remainder of the work. The costs of the work relating to repairing the faulty wiring only is deductible under subsection 53(1), provided the costs can be reasonably quantified. Tracey must be able to segregate the costs of repairing the wiring from the (capital) costs of the electrical improvements.

Example 12

111. Rebecca Medicina is the lessee of retail pharmacy premises and had practically the entire front of her shop replaced due to a truck smashing into it. Some existing materials are available to be used in the shop's restoration. The opportunity is also taken to replace some of the electrical wiring with better and more modern circuits. Rebecca is unable to segregate the costs of repair of the shop front and wiring from improvements to each of them. She is unable to establish to what extent the expenditure covers new work and to what extent it refers to renewing or replacing worn out or damaged parts. Because the costs cannot be dissected between repairs and improvements, the

whole cost is capital and not deductible: (1959) Case K 56, 10 TBRD 300; 8 CTBR (NS) Case 133.

Replacement or substantial reconstruction of the entirety

(see ruling at paragraphs 19 to 21 and explanations at paragraphs 58 to 64 of this Ruling)

Example 13

112. After a bushfire in 1993, the local State Electricity Authority undertakes a campaign to inspect the soundness of all privately owned electricity poles on rural properties. In many cases, the property owners are required to replace the poles. Mr Hogg, a pig farmer, is also required, due to the high bushfire risk in his area, to replace his poles and overhead power lines with underground cables. This expenditure is a repair and is deductible under subsection 53(1). If the electricity connection is used for both domestic and business purposes, the deduction is limited by subsection 53(3) to that part of Mr Hogg's expenditure which reasonably relates to the use of the electricity connection for business purposes. [Any amount received by Mr Hogg by way of insurance or indemnity in respect of the expenditure incurred in replacing poles or overhead wires should be included in Mr Hogg's assessable income in terms of paragraph 26(j) to the extent to which the expenditure is an allowable deduction.]

Example 14

113. Mr P Bowser owns a service station which is not connected to mains power supply. He has meters and a pumping plant to supply power to the service station. He has to replace both the meters and the pumping plant due to old age. The meters and the pumping plant are entireties in their own right, separate and distinct from the service station. Their replacement is not a repair and the cost is not deductible under subsection 53(1): Case 36, 15 TBRD(OS) 287.

'Notional' repairs

(see ruling at paragraph 16 and explanations at paragraphs 55 to 56 of this Ruling)

Example 15

114. Ken's factory uses a building in which the roof of corrugated iron needs repairing. The options are to repair the old one or to erect an entirely new one of substantially better materials over the old roof. Ken decides to adopt the second option because it will not affect production and because it will save future repairs and, in the long term, will not be significantly more expensive than the first option. By choosing the second option, Ken cannot claim a deduction as if he

had simply repaired the roof. His actual expenditure being capital, none of it is allowable as a repair.

Expenditure to remedy wear or damage in existence at the date of acquisition (initial repairs)

(see ruling at paragraphs 27 to 29 and explanations at paragraphs 68 to 78 of this Ruling)

Example 16

115. William Infelix purchases a house which was ostensibly in good repair. To make it more attractive to prospective tenants, minor repairs and renovations are undertaken. During the course of these repairs and renovations, William discovers that the woodwork is seriously affected by the ravages of white ants.

116. Substantial expenditure is incurred to remedy the problems caused by the white ant infestation to restore the property to a state in which it is suitable for occupation by tenants.

117. The expenditure incurred in these circumstances to fix the problem existing at the date of purchase is of a capital nature. It is therefore not deductible under subsection 53(1). The fact that William was unaware of the problem when he purchased the house, and the fact that he would have paid a lower purchase price if he had known of the need for repairs, do not alter the capital nature of the expense: Case 64, 11 TBRD (OS) 202 and the *W Thomas & Co* case.

Example 17

118. Colin purchases a terrace house which, considering its age, design, siting and condition, is not considered to be 'highly desirable'. Colin intends to renovate the house. He lets the house to a student for $40 per week. Shortly after, a builder commenced renovations which are completed within six months. Colin then lets the house to new tenants for $580 per month. Colin's claim for part of the renovation costs is disallowed because, when he acquired the property, the renovations were needed to be done promptly to bring it into the condition in which Colin desired to have the property for its planned long-term use.

119. The renovation costs are expenses of acquisition of the property, of a capital nature and not deductible. It does not matter that, at the date of acquisition, the premises were not so decrepit as to be incapable of generating assessable income. Nor does the cost of remedying initial defects cease to be non-deductible because some income was earned before those costs were incurred: Case W 7, 89 ATC 161; AAT Case 4845 (1988) 20 ATR 3170.

Expenditure incurred by a taxpayer on repairs to property that the taxpayer does not own

(see ruling at paragraph 30 and explanations at paragraph 79 of this Ruling)

Example 18

120. Farmer Ted Kelly has poor access to one of his main paddocks. To gain access to the paddock for sowing , reaping his crops, etc, Ted uses a road over an adjoining farm owned by Ken Hall. Ted uses his neighbour's road with Ken's concurrence. Ken's road is a sand and gravel road that is not an all-weather one. Over time, Ken's road needs to be resurfaced with a grader. Ted meets the cost of grading Ken's road The cost is deductible by Ted because he uses the road in carrying on his business to produce assessable income, even though he does not own it.

Example 19

121. Maureen and Pam conduct a restaurant business from premises that they lease. Because their landlord is reluctant to spend money on the premises, Maureen and Pam periodically undertake repairs to the premises. They are entitled to a deduction for their expenditure under subsection 53(1).

Expenditure for repairs before premises, plant, etc is held, occupied or used for income producing or business purposes

(see ruling at paragraph 31 and explanations at paragraphs 80 to 83 of this Ruling)

Example 20

122. Mary-Ellen, after the death of her spouse, decided to move out of the long-held family home and to rent it to tenants. She leaves the property on 15 July 1993. To make it a more attractive abode for prospective tenants, Mary-Ellen undertakes major repairs and renovations to the house Between August 1993 and February 1994. She lets the house to tenants on 15 March 1994. The costs of the repairs and renovations are not deductible under subsection 53(1) because when the costs were incurred Mary-Ellen had never used, and was not using, the house to produce rental income. The costs are an expense in preparing the house for rent producing. They are of a capital nature

.

Expenditure for repairs after premises, plant, etc ceases to be held, occupied or used for income producing or business purposes

(see ruling at paragraph 32 and explanations at paragraphs 84 to 88 of this Ruling)

Example 21

123. Linda owns a beachside cottage which she had rented out for five years. On her retirement, she decides to move into the cottage after tenants vacated it on 21 June 1992. In July 1993 Linda undertakes repairs on the cottage to rectify wear and tear caused by the tenants. Because the repairs were undertaken, and the expenditure was incurred, in a year of income in which the cottage was not held, occupied or used for income producing, no deduction for the expenditure is allowable.

Example 22

124. Stefan decides to sell a rental property which he has been renting for ten years. The tenants move out of the property on 5 January 1994. Stefan paints the house internally and externally in February 1994 and sells it on 15 March 1994. The painting costs are deductible under subsection 53(1) because the necessity for the painting of the property is attributable to the period it was rent producing and because the property was used during the year ended 30 June 1994, the year in which the painting costs were incurred, to produce rental income.

Expenditure for repairs to premises, plant, etc previously used for non-income producing purposes

(see ruling at paragraphs 33 to 34 and explanations at paragraphs 89 to 93 of this Ruling)

Example 23

125. Brenton Viator owns a motor vehicle which he bought in December 1984. On 1 July 1990 he applied for and got a job as a travelling salesperson and used his vehicle solely for income producing purposes. In August 1992 repairs were carried out on the vehicle. The cost of the repairs is deductible under subsection 53(1) because the costs were incurred in the 1992-93 year when the vehicle had been used, and was being used, for income producing purposes. This is so even though the repairs may relate, in part, to a period when the vehicle was used for private purposes.

Example 24

126. Brenton's friend, Emma, got a job as a travelling salesperson on 15 June 1992. Emma did not own a motor vehicle. She promptly bought a second hand vehicle on 1 July 1992 from her father who had

only used it for recreational pursuits. The vehicle's engine was in a somewhat run-down condition at the time Emma bought it. She intended to use the vehicle solely for income producing purposes. In August 1992 the vehicle's engine had to be replaced. The cost of replacing the engine, being incurred to remedy defects in the vehicle existing at the time of purchase, ie to effect initial repairs, is of a capital nature and is not deductible under subsection 53(1). Emma would be allowed a deduction for depreciation under subsection 54(1).

Example 25

127. A building is owned by a tax exempt body for a number of years. At the start of a new taxation year, the body changes its operational activities so that it is now a taxable entity carrying on business for income producing purposes. During this year, extensive repair work is done to the building. The cost of this repair work is fully deductible under subsection 53(1) even though some of the deterioration that is remedied is attributable to the period when the body was not taxable.

Expenditure for repairs to premises, plant, etc used only partly for income producing purposes during a year of income

(see ruling at paragraph 35 and explanations at paragraphs 94 to 96 of this Ruling)

Example 26

128. Josephine , a television repairer, owns a station wagon which is used for 70% business and 30% private purposes during the taxation year. Repair costs of $2 000 are incurred on the computer system in the station wagon. Because Josephine uses the station wagon for private and for business purposes, subsection 53(3) limits the amount of her deduction to that part of the expenditure which reasonably relates to the use of the station wagon for business purposes, namely, $1400. [If Josephine had recently purchased the station wagon with the defective computer system, the cost of replacing it would be an initial repair and it would not deductible under subsection 53(1). A deduction under subsection 54(1) may be allowable.]

129. **Detailed Contents List**

contents	para
What this Ruling is about	**1**
Previous Rulings now withdrawn	**5**
Ruling	**6**
Meaning of the word 'repairs'	6
Repair expenditure of a capital nature	14
Distinction between repair and either renewal or reconstruction - what is meant by the 'entirety'	19
Distinction between a repair and an improvement	22
Expenditure to remedy wear or damage in existence at the date of acquisition (initial repairs)	27
Expenditure incurred by a taxpayer on repairs to property that the taxpayer does not own.	30
Expenditure for repairs before premises, plant, etc is held, occupied or used for income producing or business purposes.	31
Expenditure for repairs after premises, plant, etc ceases to be held, occupied or used for income producing or business purposes.	32
Expenditure for repairs to premises, plant, etc previously used for non-income producing purposes.	33
Expenditure for repairs to premises, plant, etc used only partly for income producing purposes during a year of income.	35
Date of effect	**36**
Explanations	**37**
Repair expenditure of a capital nature	50
Distinction between repair and either renewal or reconstruction - what is meant by the 'entirety'	58
Distinction between a repair and an improvement	65
Expenditure to remedy wear or damage in existence at the date of acquisition (initial repairs)	68
Expenditure incurred by a taxpayer on repairs to property that the taxpayer does not own	79
Expenditure for repairs before premises, plant, etc is held, occupied or used for income producing or business purposes	80
Expenditure for repairs after premises, plant, etc ceases to be held, occupied or used for income producing or business purposes.	84
Expenditure for repairs to premises, plant, etc previously used for non-income producing purposes	89
Expenditure for repairs to premises, plant, etc used only partly for income producing purposes during a year of income	93

Examples **97**

Repair expenditure of a capital nature 99

Distinction between repair and either renewal or reconstruction - what constitutes the 'entirety' 100

Distinction between a repair and an improvement 103

Repairs and improvements effected concurrently 110

Replacement or substantial reconstruction of the entirety 112

'Notional' repairs 114

Expenditure to remedy wear or damage in existence at the date of acquisition (initial repairs) 115

Expenditure incurred by a taxpayer on repairs to property that the taxpayer does not own 120

Expenditure for repairs before premises, plant, etc is held, occupied or used for income producing or business purposes 122

Expenditure for repairs after premises, plant, etc ceases to be held, occupied or used for income producing or business purposes 123

Expenditure for repairs to premises, plant, etc previously used for non-income producing purposes 125

Expenditure for repairs to premises, plant, etc used only partly for income producing purposes during a year of income 128

Commissioner of Taxation

7 July1994

ISSN 1039 - 0731

ATO references
NO
BO STC UMG

Not previously released to the public in draft form

Price $3.50

FOI index detail
reference number

subject references
- allowable deduction
- capital
- entirety
- improvement
- initial repairs
- manufacture
- notional repairs
- renewal
- renovation
- repair
- replacement
- restoration

legislative references
- ITAA 51(1)
- ITAA 53
- ITAA 53(1)
- ITAA 53(3)
- ITAA 54(1)

case references
- FC of T v. Adams (1948) 8 ATD 332;
- Day v. Harland and Wolff [1953] 2 All ER 387;

- Hoddinott v. Newton Chambers & Co Ltd [1901] AC 49;
- FC of T v. Jax Tyres Pty Ltd 85 ATC 4001; (1984) 16 ATR 97;
- Law Shipping Co Ltd v. IR Commrs (1923) 12 TC 621;
- Lindsay v. FC of T (1960) 106 CLR 377; 12 ATD 505;
- Lister v. Lane [1893] 2 QB 212;
- London & North Eastern Railway Co v. Berriman [1946] 1 All ER 255;
- Lurcott v. Wakely & Wheeler [1911] 1 KB 905;
- Odeon Associated Theatres Ltd v. Jones (Inspector of Taxes) (1972) 1 All ER 681;
- Ready Mixed Concrete (Victoria) Pty Ltd v. FC of T (1969) 118 CLR 177; 15 ATD 215;
- Samuel Jones & Co (Devondale) Ltd v. IRC (1952) 32 TC 513;
- Sun Newspapers v. FC of T (1938) 61 CLR 337; 5 ATD 87;
- W Thomas & Co Pty Ltd v. FC of T (1965) 115 CLR 58; 14 ATD 78;
- FC of T v. Western Suburbs Cinemas Ltd (1952) 86 CLR 102; 9 ATD 452;
- FC of T v. Jack Zinader Pty Ltd (1949) 78 CLR 336; 9 ATD 46;
- Taxation Board of Review Decision Case G 61, 7 TBRD 342;
- Taxation Board of Review Decision (1959) Case K 56, 10 TBRD 300; 8 CTBR (NS) Case 133;
- Taxation Board of Review Decision (1961) Case M 2, 12 TBRD 4;
- Taxation Board of Review Decision (1960) Case M 33, 12 TBRD 187;
- Taxation Board of Review Decision Case P 5 (1963) 14 TBRD 14;
- Taxation Board of Review Decision (1965) 15 TBRD Case Q 48;
- Taxation Board of Review Decision Case 44 (1963) 11 CTBR (NS) 206;
- Taxation Board of Review Decision (1966) Case S 27, 17 TBRD ; 13 CTBR (NS) Case 56;
- Taxation Board of Review Decision (1968) Case T 75, 18 TBRD 377; 14 CTBR (NS) Case 40;
- Taxation Board of Review Decision Case 64, 11 TBRD (OS) 202;
- Taxation Board of Review Decision Case 14 (1972) 18 CTBR (NS) 82; Case D 47, 72 ATC 272;
- Taxation Board of Review Decision Case 36, 15 TBRD (OS) 287;
- Taxation Board of Review Decision 26 CTBR (NS) Case 75; Case Q 11, 83 ATC 41;
- Taxation Board of Review Decision 27 CTBR (NS) Case 26; Case Q 98, 83 ATC 487;
- Taxation Board of Review Decision Case 154 (1984) 27 CTBR (NS) 1206; Case R 101, 84 ATC 673;
- Taxation Board of Review Decision 27 CTBR (NS) Case 156; Case R 102, 84 ATC 676;
- Administrative Appeals Tribunal AAT Case 12 (1986) 18 ATR 3056; Case V 167, 88 ATC 1107;
- Administrative Appeals Tribunal AAT Case 4371 (1988) 19 ATR 3540; Case V 83, 88 ATC 580;
- Administrative Appeals Tribunal AAT Case 4845 (1988) 20 ATR 3170; Case W 7, 89 ATC 161;
- Administrative Appeals Tribunal Case W 68, 89 ATC 613; (1989) 20 ATR 3796