


TD 2006/D17 - Income tax: are there circumstances when a balancing adjustment for a car is worked out under section 40-370 instead of section 40-285 of the Income Tax Assessment Act 1997 ?

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This document has been finalised by TD 2006/49.



Draft Taxation Determination

Income tax: are there circumstances when a balancing adjustment for a car is worked out under section 40-370 instead of section 40-285 of the *Income Tax Assessment Act 1997*?

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

This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation 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. You can rely on this publication (excluding appendixes) to provide you with protection from interest and penalties in the way explained below. If a statement turns out to be incorrect and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the publication in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

Ruling

1. Yes. The special rules in section 40-370 of the *Income Tax Assessment Act 1997*,¹ instead of the general rules in section 40-285, apply to work out the balancing adjustment for a car you held where a deduction is available to you under Division 40 for the car's decline in value for an income year but you chose either the 'cents per kilometre' or '12% of original value' method under Division 28 for deducting your car expenses for the car for one or more other income years.

Example

2. *Louise acquired a car on 1 July 2002 for \$30,000 for use in her assessable income earning activities.*

3. *For the 2002-03 income year, Louise used the 'log book' method to work out her deduction for car expenses and her log book showed that the extent of her taxable purpose use was 40%. Louise chose to use the prime cost method and the Commissioner's determination of effective life of eight years to work out the decline in value of the car.*

¹ All legislative references in this determination are to the *Income Tax Assessment Act 1997*.

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4. For the 2003-04 income year, Louise decided to use the 'one-third of actual expenses' method to work out her deduction for car expenses.
5. For the 2004-05 income year, Louise decided to use the '12% of original value' method to work out her deduction for car expenses.
6. For the 2005-06 income year, Louise decided to use the 'cents per kilometre' method to work out her deduction for car expenses.
7. Louise sold her car for \$18,000 on 30 June 2006.
8. Section 40-370 applies to work out the balancing adjustment for Louise's car because Louise deducted the decline in value of her car under Division 40 for some income years (being the 2002-03 and 2003-04 income years) and used either the '12% of original value' method for another income year (being the 2004-05 income year) or the 'cents per kilometre' method for another income year (being the 2005-06 income year).
9. The relevant figures needed to apply the method statement in subsection 40-370(2) are:

Income year	Decline in value (using prime cost method, cost of \$30,000 & effective life of 8 years)	Closing Adjustable value	Reduction for non taxable purpose use
2002-03	\$3,750 (\$30,000 ÷ 8)	\$26,250 (\$30,000 - \$3,750)	\$2,250 (\$3,750 × 60%)
2003-04	\$3,750 (\$30,000 ÷ 8)	\$22,500 (\$26,250 - \$3,750)	\$2,500 (\$3,750 × 66.66%)
2004-05	\$3,750 (\$30,000 ÷ 8)	\$18,750 (\$22,500 - \$3,750)	\$2,500 (\$3,750 × 66.66%) (assumed taxable purpose use of one third – subparagraph 40-370(4)(c)(ii))
2005-06	\$3,750 (\$30,000 ÷ 8)	\$15,000 (\$18,750 - \$3,750)	\$3,000 (\$3,750 × 80%) (assumed taxable purpose use of 20% – subparagraph 40-370(4)(c)(i))
Totals	\$15,000		\$10,250

10. *The method statement in subsection 40-370(2) is applied as follows:*

Step 1: *Subtract the car's adjustable value from its termination value:*

$$\$18,000 - \$15,000 = \$3,000$$

Step 2: *Reduce the Step 1 amount by the amount attributable to non taxable purpose use:*

$$\begin{aligned} & \$3,000 - \left[\frac{\text{Reduction for non taxable purpose use}}{\text{Total decline in value}} \times \$3,000 \right] \\ & = \$3,000 - \left[\frac{\$10,250}{\$15,000} \times \$3,000 \right] \\ & = \$950 \end{aligned}$$

Step 3: *Multiply the Step 2 amount by the number of days a decline in value deduction is available:*

$$\$950 \times (365 + 366) = \$694,450$$

Step 4: *Divide the Step 3 amount by the number of days the car was held:*

$$\$694,450 \div (365 + 366 + 365 + 365) = \$475$$

Step 5: *As the Step 4 amount is positive, Louise must include the amount of \$475 in her assessable income.*

Date of effect

11. When the final Determination is issued, it is proposed to apply to years commencing both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination.

Appendix 1 – Explanation

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

Explanation

12. For most depreciating assets, a balancing adjustment is worked out under section 40-285 by comparing the asset's termination value with its adjustable value just before the balancing adjustment event occurred. The adjustable value of a depreciating asset at a particular time is the asset's cost less its decline in value (as worked out under Subdivision 40-B) up to that time.

13. A car declines in value for the purposes of Subdivision 40-B at all times it is used or installed ready for use for any purpose. However, neither the 'cents per kilometre' nor '12% of original value' method of calculating a deduction for car expenses under Division 28 includes the Subdivision 40-B decline in value of the car. Section 40-55 specifically prevents a deduction under Subdivision 40-B for the decline in value of a car for an income year for which a taxpayer uses either of these methods. The balancing adjustment for the car would therefore be overstated if the general balancing adjustment rules in section 40-285 were to apply in these circumstances. This is because the balancing adjustment for the car would be worked out having regard to the car's decline in value for the income years for which the 'cents per kilometre' or '12% of original value' method was used but would not be reduced to reflect the fact that a deduction for that decline in value was not available. It is for this reason that no amount is assessable or deductible under section 40-285 if the taxpayer has used either the 'cents per kilometre' or '12% of original value' method of deducting their car expenses for the car for one or more income years.

14. Where a taxpayer has only used the 'cents per kilometre' or '12% of original value' method under Division 28 of deducting their car expenses for the car since they began using the car and a balancing adjustment event occurs for the car, no amount will be assessable or deductible under either section 40-285 or section 40-370.² Section 40-285 does not apply in these circumstances because the application of section 40-55 means that the condition in paragraphs 40-285(1)(a) and 40-285(2)(a) is not satisfied. Similarly, section 40-370 does not apply in these circumstances because the application of section 40-55 means that the condition in paragraph 40-370(1)(b) is not satisfied.

15. Where a taxpayer has only used the 'log book' or 'one-third of actual expenses' method under Division 28 of deducting their car expenses for the car since they began using the car and a balancing adjustment event occurs for the car, the taxpayer will work out the balancing adjustment under section 40-285. Section 40-370 does not apply in these circumstances because the condition in paragraph 40-370(1)(c) is not satisfied.

16. Where a balancing adjustment is required to be worked out and the taxpayer has used a combination of the 'cents per kilometre' or '12% of original value' method and Subdivision 40-B decline in value (under the 'log book' or 'one-third of actual expenses' method) to work out their car expense deduction, section 40-370 applies. That section contains special rules to provide an appropriate reduction to the balancing adjustment to reflect the non-availability of a deduction for decline in value under the 'cents per kilometre' or '12% of original value' methods.

² See Note 2 to subsection 40-370(1).

17. A balancing adjustment under section 40-370 is worked out using the method statement in subsection 40-370(2).³ The purpose of Step 1 of the method statement in subsection 40-370(2) is to quantify the base amount of balancing adjustment by comparing the termination value and adjustable value of the car in a similar way to the general rules in section 40-285. In making this comparison, subsection 40-370(3) ensures that the decline in value of the car is worked out under Division 40 for the whole period the taxpayer held the car, including those income years for which the 'cents per kilometre' or '12% of original value' method was used. This ensures that the adjustable value and decline in value of the car for those income years the 'cents per kilometre' or '12% of original value' method was used are worked out on the same basis as the income years for which those methods were not used.

18. The purpose of Step 2 of the method statement in subsection 40-370(2) is to reduce, in a similar way to section 40-290, the base amount of balancing adjustment worked out in Step 1 by the amount that is attributable to the use of the car for purposes other than taxable purposes. In making this reduction, subsection 40-370(4) assumes the extent of taxable purpose use for those income years for which the 'cents per kilometre' or '12% of original value' method was used to be a prescribed rate. For an income year for which the '12% of original value' method was used, the car's taxable purpose use is assumed to be one-third. For an income year for which the 'cents per kilometre' method was used, the car's taxable purpose use is assumed to be 20%.

19. The purpose of Steps 3 and 4 of the method statement in subsection 40-370(2) is to work out what portion of the balancing adjustment remaining in Step 2 is attributable to those income years for which the decline in value of the car was deductible under Division 40. As the taxpayer could not deduct the decline in value of the car under Division 40 for those income years for which the 'cents per kilometre' or '12% of original value' method was used, the portion of balancing adjustment attributable to those years is thus excluded.

20. The purpose of step 5 of the method statement in subsection 40-370(2) is to specify whether an amount should be allowed as a deduction or included in assessable income.

³ See paragraphs 2 to 10 of this Determination for an example of how a balancing adjustment is worked out using the method statement.

Appendix 2 – Your comments

21. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date. (Note: The Tax Office prepares a compendium of comments for the consideration of the relevant Rulings Panel. The Tax Office may use a sanitised version (names and identifying information removed) of the compendium in providing its responses to persons providing comments. Please advise if you do not want your comments included in a sanitised compendium.)

Due date: 2 June 2006

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References

Previous draft:

Not previously issued as a draft

Subject references:

- adjustable value
- balancing adjustment event
- balancing adjustments
- car expenses methods
- uniform capital allowances system

Legislative references:

- ITAA 1997 Div 28
- ITAA 1997 Div 40
- ITAA 1997 Subdiv 40-B
- ITAA 1997 40-55

- ITAA 1997 40-285
- ITAA 1997 40-285(1)(a)
- ITAA 1997 40-290
- ITAA 1997 40-285(2)(a)
- ITAA 1997 40-370
- ITAA 1997 40-370(1)
- ITAA 1997 40-370(1)(b)
- ITAA 1997 40-370(1)(c)
- ITAA 1997 40-370(2)
- ITAA 1997 40-370(3)
- ITAA 1997 40-370(4)
- ITAA 1997 40-370(4)(c)(i)
- ITAA 1997 40-370(4)(c)(ii)

ATO references

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