IT 2142 (as amended 2/4/85) - Income tax : investment allowance - unit of property - construction and acquisition - incurring of expenditure

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TAXATION RULING NO. IT 2142 (as amended 2/4/85)

INCOME TAX : INVESTMENT ALLOWANCE
- UNIT OF PROPERTY
- CONSTRUCTION AND ACQUISITION
- INCURRING OF EXPENDITURE

F.O.I. EMBARGO: May be released

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REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1131925	INVESTMENT ALLOWANCE - UNIT OF PROPERTY - CONSTRUCTION AND ACQUISITION UNIT OF PROPERTY - CONSTRUCTION OF SUGAR MILL	82AB 82AQ

PREAMBLE Since the introduction in 1976 of the current Investment Allowance provisions (sections 82AA-AQ of the Income Tax Assessment Act), questions of the identification of the relevant "unit" of eligible property, determination of whether a unit has been "constructed" or "acquired" by the taxpayer, and the time when expenditure in respect of that acquisition or construction has been "incurred" for the purposes of sections 82AB and 82AQ have given rise to litigation.

2. In the recent case of FCT v. Tully Co-operative Sugar Milling Association Ltd (1983) 14 ATR 495, 83 ATC 4495, the Federal Court (Fox, Lockhart and Fitzgerald JJ) considered these and other issues. In the course of their judgments, their Honours made a number of observations on the operation of the Investment Allowance provisions. There has been no appeal from the Federal Court's decision. Two other decisions which bear on the issues raised in the Tully Case are Monier Colourtile Pty Ltd v. FCT (1984) 15 ATR 1256, 84 ATC 4846, and Utah Development Co. v. FCT (1983) 14 ATR 601, 83 ATC 4545.

3. The company conducted a sugar cane mill. As part of the milling process, the sugar cane passed through various crushing "mills", the extracted juice being then passed into juice tanks, heated, clarified, pumped into effet vessels (which increase the sugar content of the juice), and eventually into tanks for final processing and storage.

4. In 1976-77 the company carried out extensive upgrading of its plant, costing in total some $3.18 million. This upgrading involved, inter alia, the company erecting on site a mixed juice pumping station (incorporating starters, pumps, motors and other components supplied by third parties),

installation of a mud filter station, erecting new crushing mills (incorporating turbine gear box roller crusher, gearing and other components supplied by third parties) and the erection of juice heaters. In the case of the pumping station and the crushing mills, the company's employees erected the items on site; by contrast, the bulk of the crucial work in erecting the juice heaters was performed by third parties as sub-contractors being organised and supervised by officers of the company.

5. The Federal Court held that the mixed juice pumping station and the crushing mills were each a separate "unit" of eligible property for the purposes of section 82AB(1)(a), and had been "constructed" by the taxpayer within section 82AB(1)(a) after 1 January 1976, so that a deduction under the Investment Allowance provisions was available for such expenditure. The Court held that while the juice heaters and effet vessel were also separate units of property, the Supreme Court had held that construction of the effet vessels by the company had commenced prior to 1 January 1976, and that accordingly no deduction was available in respect of expenditure on the vessels. The company did not challenge this conclusion in the Federal Court. Neither did it contest the decision of the Supreme Court that the mud filter station was acquired under a contract entered into prior to 1 January 1976. The juice heaters were accepted as having been constructed after 1 January 1976. The Federal Court remitted certain factual issues to the Supreme Court of Queensland for determination. Those matters were resolved by consent between the parties.

6. Investment Allowance claims will invariably involve questions of fact and degree, and will turn upon a close analysis of the particular matters in question. However, the members of the Federal Court based their decision in Tully upon the following principles which they regarded as being of general application.

GENERAL CONCEPT

7. The Investment Allowance provisions are intended to confer a benefit on taxpayers, and their intended operation should not be defeated by an "illiberal" or over-technical interpretation. However, it should be noted on the other hand that the legislative intent in introducting the Investment Allowance provisions was to stimulate new private sector investment decisions by providing an incentive to taxpayers making investment decisions on or after 1 January 1976.

IDENTIFYING A "UNIT OF PROPERTY"

8. (i) The Commissioner accepts that the term "unit of ... property" in section 82AB(1) is to be construed in a broad and non-technical way (cf. per Lee J in Monier Colourtile Pty Ltd v. F.C. of T., Supreme Court of New South Wales, (1983) 14 ATR 379, 83 ATC 4399 affirmed (1984) 15 ATR 1256, 84 ATC 4846.

(ii) It is also accepted that the view expressed in Tully that a unit of property is something which can be regarded, in a meaningful sense, as a "whole", an entity entire in itself, capable of being separately identified or regarded, and having a separate function (e.g. the transportable concrete mixer in Readymix Concrete (Vic) Pty Ltd v FCT (1969) 118 CLR 184, or the multi-purpose sliver can in Wangaratta Woollen Mills Ltd v. FCT (1969) 119 CLR 1).

(iii) In light of the Tully decision, this office will continue to look to an item's intended function or purpose as the basic test in determining whether that item is a "unit of property" for Investment Allowance purposes. As explained in Monier Colourtile (supra), the test is whether either:

- the item itself performs a definable, identifiable function - this covers the situation where a number of single items, each having a specific purpose, are integrally linked so as to create a single (larger) unit having its own individual function - as where various subsidiary parts are fashioned into a motor vehicle : contrast, however, a situation where separate units of property, each retaining its individual function, are simply attached to one another - as with the truck and portable concrete mixer in Readymix Concrete (Vic) Pty Ltd v FCT (1969) 118 CLR 177; or

- the item when attached to a unit of property having its own independent function varies the performance of that unit - in such cases the attachment forms a separate unit of property. e.g. Attachments for tractors such as rippers, post-hole diggers, carry-all's and the like: Case 69 24 CTBR (NS) 621, Case M98 80 ATC 689: contrast, however, a situation where the additional item does not vary the intrinsic mode of unit's operation, but for example merely its speed of operation (Monier Colourtile (supra)).

(iv) The Tully decision confirms the view that for an item to be a unit of property for Investment Allowance purposes, it is both necessary and sufficient that it be functionally complete in itself (i.e. inherently capable of peforming its intended discrete function). An item may be a "unit" of property notwithstanding that it may be intended ultimately to operate in combination or conjunction with other units or items in order to perform some wider or commercially more "complete"

function, and notwithstanding that until it is linked or connected to those other units, it is of no practical or commercial utility or value. Thus, for example, the fact that a mobile telephone station cannot effectively communicate or receive messages without its base station (Monier Colourtiles) or that the crushing mills, juice heaters, effet vessels and other items in Tully's cane processing system could not effectively process the cane unless they all operated together, would not in either case prevent the individual items being each a separate "unit of eligible property" for Investment Allowance purposes. Factors which this office will take into account in such cases may include whether or not the items in question are mechanically interdependent, whether the items are physically separate, and whether they could be acquired separately.

(v) While the test for a unit of property focusses upon an item's inherent functional completeness, it is not necessary that a unit of property be self-contained (for example, it may draw power from an external source, as in Case 69 and Case M98 (supra) and Readymix Concrete (supra), nor need it be used in isolation (for example, it may be incorporated into an operating system).

(vi) In the light of the decision in Tully, it is accepted that a "unit of property" need not necessarily be the smallest possible individual integer which can be identified in any particular situation. Thus, in Tully itself, it was the mixed juice pumping station (rather than its component parts such as starters, motors and pumps) which was a relevant "unit" for Investment Allowance purposes.

(vii) The question of whether a particular item is a "unit" of property depends upon the facts of the particular case. The same item (e.g. a motor, or pump) may be an independent unit of property in one situation, but not in another. Difficult questions can arise where items which might themselves be individual units of property in other circumstances became integral and undifferentiated parts of a large whole. When the Tully case was before Thomas J in the Supreme Court of Queensland, his Honour seemed to suggest at 82 ATC 4454 at 4459 and 13 ATR 410 at 415, that in such circumstances the taxpayer could "choose" whether to claim the Investment Allowance on the components, or the larger whole. An item can have only one character in a given situation - i.e. either the larger whole is a unit and the components are not, or vice versa - and that this

is a question to be determined on the particular facts of the case rather than at the election of the taxpayer. The judgments of the Federal Court in Tully implicilty support this view.

THE CONCEPTS OF "ACQUISITION" AND "CONSTRUCTION"

9. In the light of the Federal Court's decision in Tully, the following principles are to be applied in relation to questions of acquisition and construction. The intent of the legislation is that the concepts of "acquisition" and "construction" should between them cover all cases, though they may well apply at different times in the development of a project (Fox J at 83 ATC 4495 at 4501, and 14 ATR 495 at 501).

10. Broadly, it may therefore be said that any particular claim for deduction in this context will fall within one of three categories:-

	(a)	Construction wholly by or under the control of the taxpayer, whether using the taxpayer's employees, or sub-contractors. However, where the work of an independent contractor is neither under the control of the taxpayer nor integrated into the taxpayer's business, the taxpayer could not usually be said to have "constructed" the unit himself.	"Construction" test applies: sub-paragraph 82AB(1)(c)(ii) - construction must commence on or after 1 January 1976 and before 1 July 1985.
	(b)	Construction wholly by persons other than the taxpayer or its employees and sub-contractors.	"Acquisition" test applies: sub-paragraph 82AB(1)(c)(i) - property must be acquired by the taxpayer under a contract entered into on or after 1 January 1976, and before 1 July 1985. Expenditure "in respect of" acquisition may include in appropriate cases transport, delivery and installation costs. However, "indirect" expenditure on, e.g. site preparation, or demolition of old plant, is not part of the cost of acquisition.
or	(c)	Construction partly by the taxpayer and partly	(i) "Construction" test (supra) will apply

by others.		to the whole unit provided the taxpayer plays the predominant role in construction: see Utah Development Co. v. FCT 83 ATC 4545 at 4551 and 14 ATR 601 at 608 where Marks J took a more liberal view by stating that it was immaterial that the construction or assembly of draglines was substantially performed by contractors for the taxpayer.
	(ii)	In other cases, the "acquisition" test (supra) will apply to the whole unit.

11. "Construction" should be given a wide meaning in the context of section 82AB(1). Section 82AQ(1) itself provides that construction includes manufacture, but one may also "construct" by assembling or building. Moreover, while installation need not necessarily involve construction, there is no strict dichotomy between these two concepts (or between the concepts of acquisition and installation).

12. A unit of property may be constructed by the taxpayer notwithstanding that parts incorporated into that unit were manufactured by and purchased from other persons.

13. There are suggestions in the judgment of Fitzgerald J in Tully that the question of when construction commences should be considered in the context of what expenses were incurred in respect of construction, and when those expenses were incurred. Since his Honour suggested that such expenditure "may in appropriate cases include costs of purchases", it would follow that "construction" may commence before the actual physical work of assembly or the like begins. To the extent that Marks J expresses a contrary view in Utah, the reasoning of Fitzgerald J is to be preferred. However, it is emphasised that each case must be dealt with in the light of its own facts and in the knowledge that in Tully components were ordered prior to 1 January 1976.

THE TIME AT WHICH EXPENDITURE IS "INCURRED" FOR THE PURPOSES OF SECTION 82AB(1).

14. The Federal Court in Tully agreed with the Commissioner's submission that the term "incurred" in section 82AB(1) should be given the same meaning as it has in section 51(1). The meaning of the term "incurred" in the context of

section 51(1) has been the subject of considerable attention from the courts and need not be explored in detail here. However, in general terms it may be said that a taxpayer will have "incurred" relevant expenditure in the present context when the taxpayer comes under a legal liability to make a (pecuniary) payment: Nilsen Development Laboratories Pty Ltd v. FCT (1981) 11 ATR 505, 81 ATC 4031.

15. Accordingly, this office will continue to take the view that expenditure is "incurred" by a taxpayer prior to 1 January 1976, where, for example, the taxpayer has come under a presently existing liability to make the payment prior to 1 January 1976, even though actual payment is made after that date. In this regard, it should be noted that the question of when the expenditure was incurred in the Tully Case was not adequately litigated in the Supreme Court. The decision of the Federal Court must be read in this context (cf. Fitzgerald J at 83 ATC 4495 at 4506 and 14 ATR 495 at 507). In this regard see the decision of Thomas J in Tully re the mud filter station and the effet vessel. Both claims were disallowed because of findings that the expenditure was incurred outside the relevant period.

COMMISSIONER OF TAXATION
15 March 1985