IT 2493 - Income tax : substantiation rules : calculation of balancing adjustment

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TAXATION RULING NO. IT 2493

INCOME TAX : SUBSTANTIATION RULES :
CALCULATION OF BALANCING ADJUSTMENT

F.O.I. EMBARGO: May be released

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REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1010783	DEPRECIATION	82KW(3)
	BALANCING ADJUSTMENTS	82KY(6)
	SUBSTANTIATION	

OTHER RULINGS ON TOPIC :

PREAMBLE This Ruling provides guidance on the application of subsection 82KY(6) in Subdivision F of Division 3 of Part III of the Income Tax Assessment Act 1936 (the Act). That Subdivision contains the income tax substantiation rules which allow a taxpayer to substantiate car expenses by one of several methods.

2. Subsection 82KY(6) has relevance for taxpayers who choose to substantiate car expenses under either the '12%-of-the-cost price-of-the-car' method (the 12% method) or the 'set rate-per-kilometre' method. The subsection provides a basis for determining a balancing adjustment under section 59 of the Act in relation to a car that has been the subject of elections under subsection 82KW(3) (the 12% method) or subsection 82KX(1) (the set-rate per-kilometre method) and in respect of which a depreciation deduction has previously been allowed.

3. By way of background, section 59 of the Act applies on the sale or other disposal of depreciated property. If, on disposal, the depreciated value of the property used solely to produce assessable income exceeds the proceeds received, the excess is an allowable deduction. On the other hand, if the depreciated value of such property is less than the proceeds, the difference is included in the taxpayer's assessable income as depreciation recovered. Prorating of these adjustments occurs if the property has been used only partly for producing assessable income. Special rules apply if the proceeds of disposal exceed the cost of the property and also if the proceeds fall between the 'actual' and 'notional' depreciated values. (The 'actual' depreciated value is the cost of the property less the total depreciation actually allowed to the taxpayer: the 'notional' depreciated value is that cost less the total depreciation calculated as if the property were used solely to produce assessable income.)

4. Subsection 82KY(6) will operate where:

- depreciation in respect of a car has been allowed as a deduction;
- the taxpayer has elected to adopt one of the arbitrary bases of deduction available under either subsection 82KW(3) or 82KX(1); and
- the car is subsequently disposed of, lost or destroyed.

RULING

5. Subsection 82KY(6) authorises the Commissioner of Taxation to calculate a notional depreciated value of the car at the time of disposal as if an arbitrary basis of deduction had never applied. The notional calculation is made by treating the taxpayer's use of the car during the year(s) when an arbitrary basis of deduction applied as having been used for the purpose of producing assessable income. The car is treated as having been used to the extent of 33 1/3% for business purposes during any year in which the 12% method applied, or to the extent of 20% where the set-rate-per-kilometre method applied.

6. Paragraph 82KY(6)(g) authorises an adjustment to be made to the amount of a section 59 balancing adjustment that is calculated by reference to a car's notional depreciated value. The paragraph 82KY(6)(g) adjustment is made by dividing the full period for which traditionally calculated depreciation was allowed by the aggregate of that period and the period in which an arbitrary basis of deduction applied and multiplying the result by the total depreciation notionally allowable on the car. The result is that any balancing adjustment relates only to the actual depreciation allowed.

7. The following example illustrates the practical application of subsection 82KY(6).

8. Assume that a taxpayer purchases a car on 1 August 1984 for $13,898 and sells it on 30 April 1988. For the years ended 30 June 1985 and 30 June 1986, 20% of the car's use has been business use. After the introduction of the income tax substantiation rules, the taxpayer elected to claim car expenses to the date of disposal under the 12% method.

9. The relevent calculations of depreciation and depreciated or written down values (W.D.V.) are:

	NOTIONAL W.D.V.	ACTUAL W.D.V.
Cost on 1.8.1984	$13,898	$13,898
Depreciation (22 1/2%) to 30.6.85	-2,866	(20% business)-573
	11,032	13,325
Depreciation (22 1/2%) to 30.6.86	-2,482	(20% business)-496
	8,550	12,829
Depreciation (22 1/2%) to 30.6.87	-1,924	(deemed 33 1/3% -641

	6,626	business)	12,188
Depreciation (22 1/2%) to 30.4.88	- 1,242	(deemed 33 1/3%	-414
	5,384	business)	11,774

Total notional depreciation is $8514 (2866 + 2482 + 1924 + 1242). Total actual depreciation is $2124 (573 + 496 + 641 + 414).

10. If the car were sold for $4,000, the allowable deduction on disposal (before applying subsection 82KY(6)) would be:

($5,384 - $4,000) x $2,124 / $8,514 i.e., $345.

11. However, paragraph 82KY(6)(g) requires the subsection 59(1) deduction of $345 so calculated to be reduced to exclude the amount attributable to the period during which subsection 82KW(3) applied to entitle the taxpayer to a deduction equal to 12% of the cost of the car. In the example, depreciation was allowed for 11 months of the 1984-85 income year and 12 months of the 1985-86 income year, whereas subsection 82KW(3) applied for 22 months from 1 July 1986 to 30 April 1988. The appropriate subsection 59(1) deduction, therefore, is

23 / 45 x $345, i.e., $176,

so that a deduction is denied in relation to the 22 months for which the 12% method applied.

12. If the car were sold for $9,500 , there would be no section 59 adjustment on sale, because the sale price falls between the notional and actual written down values.

13. If the car were sold for $13,000, the subsection 59(2) balancing adjustment (before applying subsection 82KY(6)) is $13,000 - $11,774, i.e., $1226 depreciation has been recovered. However, applying the paragraph 82KY(6)(g) apportionment previously explained, the amount included in assessable income under subsection 59(2) would be

23 / 45 x $1226, i.e., $626,

so that no amount is included in assessable income in relation to the 22 months for which the 12% method applied.

14. If the sale price exceeded the cost of the car ($13,898), the subsection 59(2) assessable amount (before adjustment) would be $13,898 - $11,774, i.e., $2124. That amount is adjusted under paragraph 82KY(6)(g) in the same manner, so that only $1086 is included in the assessable income. Any excess of the sale price over $13898 would usually be a capital gain and be taxable as such (if the car were acquired after 19 September 1985) but for the specific exclusion of certain motor vehicles from the definition of 'asset' for capital gains tax purposes. It follows, of course, that taxable capital gains can arise on the sale of other depreciable assets.

COMMISSIONER OF TAXATION
4 August 1988