IT 2685 - Income tax: depreciation

Australian Taxation Office

Taxation Ruling
Income tax: depreciation

Income Tax Rulings do not have the force of law. Each decision made by the Australian Taxation Office is made on the merits of each individual case having regard to any relevant Ruling.

contents para

What this Ruling is about

1. This Ruling contains the Commissioner of Taxation's depreciation determination under section 54A of the *Income Tax Assessment Act 1936*. It also explains the change in the method of fixing depreciation rates:

. commencing with the beginning of the 1991/92 income year; and

. for plant or articles acquired after 26 February 1992.

Ruling

2. Section 54A requires the Commissioner of Taxation to make a determination of the effective lives of particular items of plant, which taxpayers may adopt as an alternative to making their own estimate of effective life. That determination is set out in the attached table.

3. For convenience, the table also lists the applicable depreciation percentages under the rules that applied from the beginning of the 1991/1992 income year and the rules commencing 27 February 1992. Those percentages are expressed in both prime cost and diminishing value terms.

Date of effect

4. The rates specified in the table should only be used to calculate depreciation deductions for the 1991/92 income year and later years. Claims for previous years should be based on rates published in Income Tax Order 1217 or as specially approved.

Explanations

Effective life

5. The effective life of a particular item of plant is used to determine its relevant depreciation rate for tax deduction purposes. Broadly, the effective life of a particular item is the period of time the item can be expected to be used for income-producing purposes, assuming it is kept in good order and condition.

Commissioner's published advisory rates

6. Until 1 July 1991, the Commissioner of Taxation had authority to determine the effective life of each item of plant when it became eligible for depreciation deductions and thereby fix the relevant rate of depreciation. For example, if the Commissioner determined the effective life of a particular item as 20 years, the basic rate of depreciation would be 5 percent per annum.

7. The rate of depreciation for a particular item of plant remains unchanged once it has been set, even in the hands of subsequent owners.

8. As a practical measure, the Commissioner has published Income Tax Order 1217 (ITO 1217) which specifies basic depreciation rates for particular classes of plant. Taxpayers have been able to rely on those published rates instead of seeking a specific determination from the Commissioner in respect of their own individual items of plant.

Self-assessed effective lives

9. From 1 July 1991, taxpayers may make their own estimate of the effective life of assets that they acquire after 12 March 1991.

10. Taxpayers will need to estimate the period during which the asset could reasonably be expected to be used in producing assessable income, based on that particular taxpayer's circumstances of use.

11. Sometimes, taxpayers will sell an asset at a time when its useful life has not expired. The time of sale is not to be treated as the end of the asset's effective life. Instead, at the time when a taxpayer first uses an asset (or installs it ready for use as reserve plant), the taxpayer needs to estimate effective life on the assumption that the asset will not be disposed of but will continue to be used by the taxpayer until it would no longer be useful for income-producing purposes.

12. An asset which is not new at the time it first becomes depreciable to a particular taxpayer is to be assumed to be new in estimating its effective life.

13. Factors to be taken into account in making an estimate of effective life include:

- potential physical life;
- expected circumstances of use by the particular taxpayer;
- predictable obsolescence; and
- whether the effective life is restricted by the duration of a particular project.

14. The sort of information which could be used to make an estimate would include:

- the manufacturer's specifications;
- independent engineering information;
- the taxpayer's own past experience with similar assets;
- past experience of other users of similar assets.

15. Details of how an estimate is made need to be retained for five years.

Amendments to estimates of effective life

16. Estimates of effective life are to made objectively by reference to all relevant information available at the time an asset first becomes depreciable. If that estimate is reasonably made on the best available information, it is not open to either the taxpayer or the Commissioner to vary that estimate to reflect information gained with the benefit of hindsight.

17. However, if a taxpayer later realises that an estimate was not reasonably made on the facts - for example, that an incorrect conclusion was drawn from the available facts, or an error of calculation was made - then it will be open to the taxpayer, under the usual rules, to seek an amendment of prior assessments to reflect the correct rate of depreciation.

Option to adopt Commissioner's estimate

18. As an alternative to "self-assessing" effective lives, taxpayers may make a written election to adopt effective lives as determined by the Commissioner. The precise form of an election is at a taxpayer's

discretion and is not required to be lodged with income tax returns. An election needs to be retained for five years after the earlier of the disposal, loss or destruction of the asset.

19. The Commissioner's determination of effective lives, set out in the attached table, largely reflects earlier determinations upon which the rates published in ITO 1217 were fixed in relation to income years before the 1991/92 year.

20. Those earlier determinations were based on estimates of the average effective life of classes of assets in common use. In some instances, separate rates have been set for a particular class of asset when used in different circumstances. For example, a higher rate has applied to carpeting for use in public places compared to use in private rental accommodation, reflecting the likely higher rate of wear and tear in the former use.

21. That approach will continue under the new arrangements. Taxpayers wishing to adopt a period different from one specified in the Commissioner's determination will need to make their own estimate, as described in paragraphs 9 to 15.

Variation of existing determination

22. The Commissioner will review an existing determination if it can be demonstrated that it is no longer appropriate. For example, a change in technology may mean that the average effective life of a class of asset has changed. Or a particular industry may be able to justify a special rate for its members.

23. Accordingly, industry groups are invited to approach the Taxation Office for a review of an existing determination if they feel it is not a fair estimate of average effective life.

Application for item not listed

24. Similarly, applications can be made for the Commissioner to determine the effective life for a class of asset not specified in the attached table. The period set will reflect what is appropriate for a broad range of users or a particular class of taxpayers.

Rates of depreciation

System before 1 July 1991

25. Before 1 July 1991, unless special rates applied, depreciation rates were fixed according to the Commissioner's determination of effective life. For example, if the effective life of an asset was 10 years, the basic rate of depreciation was 10 percent per annum.

26. The following summarises a number of concessions that have applied to assets acquired before 1 July 1991.

Loadings

27. Basic rates of depreciation could be increased by a loading of either 18% or 20%, depending on when property was acquired. For instance, assets acquired after 25 May 1988 were eligible for a loading of 20%. So, a basic rate of depreciation of 10% prime cost (15% diminishing value) was increased to 12% prime cost (18% diminishing value) by the loading.

28. The following are the loading rates which have applied:

Date of purchase contract or commencement of construction	Loading %
before 20 August 1980	0
after 19 August 1980 and before 1 May 1981	20
after 30 April 1981 and before 26 May 1988	18
after 25 May 1988	20

29. Loadings do not apply to motor cars and derivatives, motor cycles and other vehicles designed to carry either less than 1 tonne or fewer than nine passengers. Those vehicles were depreciated at basic rates only.

30. Nor did loadings apply to plant eligible for write-off at the following special rates:

- "employee amenities" which are depreciable at 33 1/3% under the prime cost method or 50% under the diminishing value method; employee amenities means property for use principally in providing clothing cupboards, first aid, rest-rooms, recreational facilities, cafeterias and the like for employees or for the care of employees' children;

. plant for use in scientific research which is depreciable at 33 1/3% under the prime cost method or 50% under the diminishing value method;

. "Australian trading ships" which are eligible for a 5 year write-off;

. plant used in "basic iron or steel production" which was eligible for a 3 or 5 year write-off, depending on the relevant basic rate of depreciation as increased by the loading;

. a number of repealed "5/3" concessions under which assets could be depreciated over 5 or 3 years, depending upon the relevant loaded basic rate of depreciation.

System from 1 July 1991

31. The March 1991 Industry Statement foreshadowed a number of changes to depreciation which generally apply from 1 July 1991, including:

. immediate deductibility for low cost and short life assets;

. a new seven rate schedule for most assets; and

. the option to either self-assess effective life or adopt periods specified by the Commissioner of Taxation (discussed at paragraphs 9 and 18 respectively).

Immediate deduction

32. An immediate deduction is available for plant acquired on or after 1 July 1991 either costing $300 or less or with an effective life of less than 3 years.

Broadbanding

33. Commencing with the 1991/92 income year, depreciation rates have been rationalised ("broadbanded") so that the number of different depreciation rates was reduced.

34. Under broadbanding, there are 7 basic rate classes - 33 1/3%, 20%, 15%, 10%, 7 1/2%, 5% or 2 1/2%. If the basic rate of depreciation for an item is not one of the seven broadbanded rates, the basic rate is adjusted to the next highest broadbanded rate. For example, if the effective life of an item was 12 years, its basic rate would be 8%; that rate would then be adjusted up to 10%, the next highest broadbanded rate.

20% loading

35. Basic rates for assets are further increased by a standard loading of 20%. The loaded rate is then increased by 50% if the diminishing value method of calculating deductions is used. So, using the example above, the broadbanded basic rate of 10% becomes 12% after loading (18% diminishing value).

When broadbanding applies

36. Broadbanding first applies in the 1991/92 income year including plant acquired before 1 July 1991. (However, as discussed at paragraph 48, new rules apply to assets acquired after 26 February 1992.) Broadbanding is optional; that is, an election can be made to retain a basic rate that is not one of the seven broadbanded rates.

37. The following table sets out the relevant rates of depreciation where both broadbanding and the 20% loading apply:

Years in effective life	Prime cost	Diminishing value
3 to less than 5	40%	60%
5 to less than 6 2/3	24%	36%
6 2/3 to less than 10	18%	27%
10 to less than 13 1/3	12%	18%
13 1/3 to less than 20	9%	13.5%
20 to less than 40	6%	9%
40 or more	3%	4.5%

Loading does not apply to certain motor vehicles

38. The 20% loading does not apply to passenger motor vehicles and derivatives, motor cycles and other vehicles designed to carry less than either 1 tonne or nine passengers. The following table sets out the applicable rates of depreciation for those sorts of motor vehicles:

Years in effective life	Prime cost	Diminishing value
3 to less than 5	33.3%	50%
5 to less than 6 2/3	20%	30%
6 2/3 to less than 10	15%	22.5%
10 to less than 13 1/3	10%	15%
13 1/3 to less than 20	7.5%	11.25%
20 to less than 40	5%	7.5%
40 or more	2.5%	3.75%

Works of art

39. Broadbanding does not apply to originals or reproductions of paintings, sculptures, drawings, engravings, photographs, and similar things. However, the 20% loading does apply. For example, if the effective life of a painting was 100 years, the basic rate would be 1%. The 20% loading would then increase that rate to 1.2% (1.8% diminishing value).

Special rates of depreciation

40. Broadbanding and the 20% loading do not apply to the following assets eligible for concessional write-offs:

- "employee amenities" and "scientific research" plant which are depreciable at 33 1/3% under the prime cost method and 50% under the diminishing value method, whatever their actual effective life;
- assets deductible under the special provisions for "Australian trading ships" (5 year write-off) and "basic iron or steel production" (3 or 5 year write-off).
- assets that are being depreciated under repealed measures which gave special deductions over 3 or 5 years;

Broadbanding and assets acquired before beginning of 1991/92 income year

41. Broadbanding also applies to assets acquired before the beginning of the 1991/92 income year; that is, before 1 July 1991 for taxpayers whose income years commence on 1 July each year. Taxpayers will be able to increase the rates of depreciation that they previously used for such assets other than "works of art", if the basic

rates on which those rates were fixed are not one of the 7 broadbanded rates.

42. Broadbanding does not apply to assets eligible for the special rates of depreciation mentioned at paragraph 40. Those assets continue to be depreciable at the applicable special rates until either fully depreciated or sold, scrapped or destroyed.

43. The table below lists the various broadbanded rates, increased by the 20% loading, and the corresponding diminishing value rates. It can be used to work out whether an increased rate applies to an asset, other than motor vehicles not eligible for the 20% loading and "works of art", acquired before the 1991/92 income year.

44. The table also shows the broadbanded rates without the 20% loading, relevant for motor vehicles not entitled to the 20% loading.

45. If, before the 1991/92 income year, an asset was being depreciated under the prime cost method and the prime cost rate being used is not one of the prime cost rates listed in the table, the next highest listed prime cost rate can be used to calculate depreciation deductions for that asset in 1991/92 and later years. Similarly, if a diminishing value rate does not appear in the table, the next highest diminishing value rate can be used.

Broadbanded rates with 20% loading		Broadbanded rates without 20% loading	
Prime cost	Diminishing value	Prime cost	Diminishing value
40%	60%	33.3%	50%
24%	36%	20%	30%
18%	27%	15%	22.5%
12%	18%	10%	15%
9%	13.5%	7.5%	11.25%
6%	9%	5%	7.5%
3%	4.5%	2.5%	3.75%

Assets acquired between 12 March 1991 and 1 July 1991

46. For assets acquired after 12 March 1991 and before 1 July 1991, depreciation deductions for the period before 1 July 1991 are to be calculated under the general depreciation rules (explained in paragraphs 25 to 30) that applied up to 30 June 1991.

47. However, from 1 July 1991, depreciation rates applicable to such assets may be set under the "self-assessment" procedures

described at paragraphs 9 to 15 or by adopting the effective life determined by the Commissioner (see paragraphs 18 to 21).

Example

A taxpayer acquires an asset on 1 May 1991 for which the Commissioner has specified a basic rate of 10% based on an effective life of 10 years. With the loading of 20%, the relevant rates would be 12% prime cost and 18% diminishing value. Depreciation for the period 1 May 1991 to 30 June 1991 would be calculated using those rates.

The taxpayer has estimated that the effective life of the asset under his/her particular circumstances of use is 8 years. From 1 July, the taxpayer could either fix the applicable rate according the taxpayers own estimate of 8 years or continue with rates based on the Commissioner's determination of 10 years.

If the taxpayer decided to use his/her own estimate, the relevant broadbanded rates would be worked out as follows:

(1) The effective life of 8 years is divided into 100 which gives a basic rate of 12.5%.

(2) That basic rate is not one of the 7 broadbanded rates and would be adjusted to the next highest broadbanded rate of 15%.

(3) The broadbanded rate would then be increased by 20% to 18% prime cost. The diminishing value rate would be 50% higher than the prime cost rate, at 27%.

If the taxpayer instead decided to continue with the Commissioner's effective life, the relevant depreciation rates would remain at 12% prime cost and 18% diminishing value - they are broadbanded rates and no increase would be available.

Assets acquired after 26 February 1992

New six rate schedule

48. The One Nation Economic Statement foreshadowed a new six rate schedule to replace the seven broadbanded rates. The new rates apply to assets, whether new or second-hand, acquired after 26 February 1992. Assets acquired before 27 February 1992 continue to be depreciable under the broadbanding rules described above.

49. An asset is taken to be acquired after 26 February 1992 if either acquired under a contract entered into after that date, or, if constructed by the taxpayer, construction commenced after that date.

50. The new rates will not apply to assets acquired after 26 February 1992 from an "associate" if the associate acquired the asset before 27 February 1992. Nor will they apply to pre-27 February 1992 assets involved in sale-leasebacks after 26 February 1992. In those cases, the asset would continue to be treated as acquired before 27 February 1992.

51. The meaning of associate is quite extensive and broadly applies to relatives and partners of a taxpayer or trusts or companies which a taxpayer controls.

52. Under the new arrangements, items either costing $300 or less or with an effective life of less than 3 years continue to be immediately deductible. As well, the rates of depreciation for assets with effective lives of 3 to less than 5 years remain unchanged. However, the rates for assets with effective lives of 5 or more years have increased.

53. The new depreciation rates are expressed as diminishing value rates. The corresponding prime cost rates are 2/3rds of the diminishing value rates, rounded to the nearest whole number. The following table summarises the new rates:

Years in effective life	Prime cost	Diminishing value
3 to less than 5	40%	60%
5 to less than 6 2/3	27%	40%
6 2/3 to less than 10	20%	30%
10 to less than 13	17%	25%
13 to less than 30	13%	20%
30 or more	7%	10%

The table does not apply to the following:

Excluded motor vehicles

54. Rates for passenger motor vehicles and derivatives, motor cycles, and other vehicles designed to carry either less than 1 tonne or fewer than 9 passengers remain unchanged from those applicable under the rules that apply from 1 July 1991, as explained at paragraph 38. However, prime cost rates are rounded to the nearest whole number.

55. The following table can be used to work out the relevant depreciation rate for such vehicles.

Years in effective life	Prime cost	Diminishing value
3 to less than 5	33%	50%
5 to less than 6 2/3	20%	30%
6 2/3 to less than 10	15%	22.5%
10 to less than 13 1/3	10%	15%
13 1/3 to less than 20	8%	11.25%
20 to less than 40	5%	7.5%
40 or more	3%	3.75%

Employee amenities and scientific research plant

56. "Employee amenities" and "scientific research plant" are depreciable at a minimum of 33% prime cost or 50% diminishing value.

Works of art

57. Diminishing value depreciation rates for "works of art" are calculated by dividing effective life into 1.8 and multiplying by 100. The prime cost rate is 2/3rds of that rate, rounded to the nearest whole number.

58. For example, a painting with an effective life of 100 years would have a diminishing value rate of 1.8% and a prime cost rate of 1% (rounded to the nearest whole number).

New rates are maximum

59. Rates fixed under these measures represent the maximum rates at which assets may be depreciated. Lower rates can be adopted each year at taxpayers' discretion.

Immediate deductions - administrative arrangements

60. It has been a longstanding practice to permit taxpayers to treat initial purchases of certain items as not depreciable and to claim an immediate deduction for replacements.

61. That practice principally relates to low cost items that have very long or indeterminate effective lives but are subject to frequent replacement through loss or breakage; for example, crockery and loose tools. It is also administratively simpler for some taxpayers who would otherwise be required to calculate depreciation for a myriad of low cost items and separately account for losses or breakages.

62. Items for which the Commissioner is prepared to accept that practice have been identified in the publication of advisory depreciation rates (ITO 1217).

63. That arrangement is to continue. However, with the introduction of immediate deductions for items either not costing more than $300 or with effective lives or less than 3 years, the arrangement now need only apply to items which are not otherwise immediately deductible. Items for which the replacement method may be adopted are identified in the attached table.

64. Another longstanding practice has been to allow mining companies and other taxpayers involved in large scale operations immediate deductions for items not costing more than $500 (Taxation Ruling IT 2264). That arrangement is also to continue.

Commissioner of Taxation

6 November 1992

ISSN 0813 - 3662

ATO references
NO 91/10807-1
92/854-2
BO

Not previously released to the public in draft form

Price $7.50

FOI index detail
reference number
I 1013254

subject references
- depreciation determination
- effective life
- rates of depreciation

legislative references
- ITAA 54
- ITAA 54A
- ITAA 55