TR 97/23 - Income tax: deductions for repairs

Taxation Ruling
Income tax: deductions for repairs

other Rulings on this topic

IT 180; IT 242; IT 2183; TR 95/21; TR 97/16

contents para

This Ruling, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the ***Taxation Administration Act 1953****, is a public ruling for the purposes of that Part. Taxation Ruling TR 92/1 explains when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Ruling is about

Class of person/arrangement

1. This Ruling explains the circumstances in which expenditure incurred by a taxpayer for repairs is an allowable deduction under section 25-10 of the *Income Tax Assessment Act 1997* ('the ITAA 1997') - formerly contained in section 53 of the *Income Tax Assessment Act 1936* ('the ITAA 1936'). It consolidates most prior Taxation Rulings and Taxation Determinations on repairs. The Ruling deals with:

(a) the meaning of the word 'repairs' in subsection 25-10(1), and in the former subsection 53(1);

(b) repair expenditure of a capital nature;

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

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

(e) expenditure to remedy defects, damage or deterioration in existence at the date of acquisition of property (that is, an initial repair);

(f) some specific issues in construing section 25-10 and the former section 53;

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

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

(i) expenditure for repairs to property used for the purpose of providing non-deductible entertainment; and

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

2. The following expressions in section 25-10 and the former section 53, in column 1, are abbreviated at times in this Ruling as indicated in column 2:

Expression in section 25-10 (column 1)	***Abbreviation in this Ruling (column 2)***
'premises (or part of premises), plant, machinery, tools or articles'	'property'
'held or used'	'held, etc.,'
'purpose of producing assessable income'	'income purposes'
Expression in section 53 (column 1)	***Abbreviation in this Ruling (column 2)***
'premises, or part of premises, plant, machinery, implements, utensils, rolling stock or articles'	'property'
'held, occupied or used'	'held, etc.,'
'purpose of producing assessable income, or in carrying on a business for that purpose'	'income purposes'

3. In this Ruling, a reference to:

- 'section 8-1' means, as appropriate, 'section 8-1 of the ITAA 1997 or the former subsection 51(1) of the ITAA 1936';
- 'section 25-10' means, as appropriate, 'section 25-10 of the ITAA 1997 or the former subsection 53(1) of the ITAA 1936';
- 'section 42-15' means, as appropriate, 'section 42-15 of the ITAA 1997 or the former subsection 54(1) of the ITAA 1936';
- 'the old law' means 'the former subsection 53(1) of the ITAA 1936'; and
- 'the new law' means 'section 25-10 of the ITAA 1997'.

4. In this Ruling, the expression 'initial repair' refers to a repair by a taxpayer that remedies some defect in property or makes good damage

to, or deterioration of, property being a defect, damage or deterioration:

(a) existing when the property was acquired from another person (whether by purchase, lease or licence); and

(b) not arising from the operations of the taxpayer who incurs the repair expenditure.

5. A repair is not an 'initial repair' simply because it is the first repair made after property is acquired. It is an 'initial repair' if repair is due when the property is acquired in the sense that the property has defects, damage or deterioration or is not in good order and suitable for use in the way intended.

6. This Ruling does not consider in detail the circumstances in which a loss or outgoing for repairs may be deductible under the general deduction provision (section 8-1) or under the depreciation deduction provision (section 42-15). Repairs may include some maintenance work but only if it is done in conjunction with work that is a repair. Repairs may not involve only maintenance work. If non-capital maintenance work is not a repair, it may be deductible under section 8-1. If expenditure on maintenance work is of a capital nature, it may be depreciable under section 42-15.

7. Section 8-10 of the ITAA 1997 provides a rule against double deductions. If expenditure on repairs is potentially deductible under both sections 25-10 and 8-1, section 8-10 provides that you can deduct only under the provision that is most appropriate. Which provision is the most appropriate is an objective question. In our view, if both sections 25-10 and 8-1 allow you to deduct the same amount, section 25-10, being the provision that deals specifically with repair expenditure, is the most appropriate provision.

8. Under the old law, if expenditure on repairs is potentially deductible under both subsections 53(1) and 51(1), we consider it is more 'appropriate' in exercising the discretion in subsection 82(1) (no double deductions) that the deduction be allowed under subsection 53(1) rather than 51(1): see *Case Q98* 83 ATC 487 at 489; *Case 26* (1983) 27 CTBR (NS) at 160.

9. The Ruling does not deal with the question whether expenditure for repairs after property ceases to be held, occupied or used for income producing or business purposes is deductible under section 25-10 or under the old law. Taxation Ruling IT 180 addresses this question for the old law. Because section 25-10 expresses the same ideas as the old law, IT 180 also applies to the new law: Taxation Ruling TR 97/16, paragraph 17.

10. The Ruling also does not deal with the question whether expenditure for repairs may be included in the cost base of an asset for

the purposes of the capital gains provisions, nor with the depreciation and other capital allowance provisions in the income tax law.

Previous Rulings

11. This Ruling replaces Taxation Rulings IT 153, IT 2089 (which was withdrawn on 3 September 1997), IT 2116, IT 2149, IT 2183, IT 2587 and Taxation Determination TD 92/180. These Rulings and the Determination are now withdrawn.

Ruling

Meaning of the word 'repairs'

(Note: see explanation at paragraphs 83 to 107 and examples at paragraphs 162 and 163 of this Ruling)

Context of the word 'repairs' in section 25-10

12. In its context in section 25-10, the word 'repairs' relates to work done to 'premises (or part of premises), plant, machinery, tools or articles'. The word 'repairs' appeared in a similar context in the old law. While the things specified in the section cover a wide range of property, they do not extend to all classes of property, e.g., intangible property.

Ordinary meaning of 'repairs'

13. The word 'repairs' has its ordinary meaning. It ordinarily means the remedying or making good of defects in, damage to, or deterioration of, property to be repaired (being defects, damage or deterioration in a mechanical and physical sense) and contemplates the continued existence of the property.

14. Work done to prevent or anticipate defects, damage or deterioration (in a mechanical or physical sense) in property is not in itself a 'repair' unless it is done in conjunction with remedying or making good defects in, damage to, or deterioration of, the property.

15. Repair for the most part is occasional and partial. It involves restoration of the efficiency of function of the property being repaired without changing its character and may include restoration to its former appearance, form, state or condition. A repair merely replaces a part of something or corrects something that is already there and has become worn out or dilapidated. Works can fairly be described as

'repairs' if they are done to make good damage or deterioration that has occurred by ordinary wear and tear, by accidental or deliberate damage or by the operation of natural causes (whether expected or unexpected) during the passage of time.

16. To repair property improves to some extent the condition it was in immediately before repair. A minor and incidental degree of improvement, addition or alteration may be done to property and still be a repair. If the work amounts to a substantial improvement, addition or alteration, it is not a repair and is not deductible under section 25-10.

Restoration of the efficiency of function of the property

17. 'Repairs', in its context in section 25-10, is directed to the holding or use of property for income purposes. Under the old law, the property had to be 'held, occupied or used' for income purposes. Holding or use of property for this purpose indicates that, in determining whether work done to property constitutes 'repairs', it is more significant to consider whether the work restores the efficiency of function of the property without changing its character than it is to consider whether the appearance, form, state or condition of the property is exactly restored.

Need for exercise of judgment

18. We recognise that in some cases practical difficulty may be involved in deciding, for the purpose of deductibility of repair expenditure under section 25-10, whether the property is returned to its original efficiency of function by particular work done to it. We accept that there can be sound commercial and other reasons for doing work on property to improve its appearance, condition or functional efficiency. The question is necessarily one of fact and degree. It requires a careful weighing of the various factors discussed in this Ruling and exercising judgment in the light of decided case law and practical commercial experience. If a taxpayer is experiencing practical difficulty in deciding whether particular repair expenditure is deductible, he or she can seek a private binding ruling from the Australian Taxation Office ('the ATO').

Maintenance work - whether 'repair'

19. Work done partly to remedy or make good defects, damage or deterioration does not cease to be a repair if it is also done partly - even largely - to prevent or anticipate defects, damage or deterioration (in a mechanical or physical sense) in property or in rectifying defects

in their very early stages. Repairs are not confined to rectifying defects, damage or deterioration that have already become serious. Work done to property not in need of repair, however, is not **repair** work and any expenditure for the work in these circumstances is not deductible under section 25-10.

20. Some kinds of maintenance work are 'repairs' in terms of section 25-10, for example, painting plant or business premises to rectify existing deterioration **and** to prevent further deterioration. Other kinds of maintenance work, such as oiling, brushing or cleaning something that 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 the section . Expenditure on the latter kind of maintenance work may be an allowable deduction under section 8-1.

Question of fact and degree

21. What is a 'repair' for the purposes of section 25-10 is a question of fact and degree in each case having regard to the appearance, form, state and condition of the particular property at the time the expenditure is incurred and to the nature and extent of the work done to the property.

22. If work done to property goes beyond what is a 'repair' in terms of section 25-10, any expenditure for the work is not deductible. The work may go beyond 'repairs' in terms of the section if it:

(a) changes the character of the property; or

(b) does more than restore its efficiency of function.

(The cost of this work may be deductible under other provisions of the income tax law, e.g., section 8-1 or section 42-15 or Division 43 of the ITAA 1997 (or the former Division 10C or 10D of Part III of the ITAA 1936).)

Work done solely to meet requirements of regulatory bodies

23. To determine whether work done to meet requirements of regulatory bodies, or to conform with their standards, constitutes 'repairs' for the purposes of section 25-10, it is necessary to consider the general principles and the various factors discussed in this Ruling.

24. Expenditure on work that modifies property to satisfy regulatory requirements is allowable under section 25-10 as repair expenditure only if the work:

(a) remedies or makes good a defect in, damage to, or deterioration (in a mechanical or physical sense) of, property; and

(b) restores the efficiency of function of the property; and

(c) does not produce a new and different function for the property nor add to the property a function that it did not previously have.

25. The expenditure must not be of a capital nature, e.g., an improvement.

Expenditure to control health risks from dangerous substances

26. Work done to property in controlling health risks associated with the use of dangerous substances (such as asbestos, chloroflurocarbons ('CFCs'), chromium, dioxin, cyanide, pesticides and arsenic) does not qualify as a 'repair' for the purposes of section 25-10 unless the work remedies or makes good defects in, damage to, or deterioration (in a mechanical or physical sense) of, the property.

27. An example of expenditure that is not deductible as a repair is the cost of removing asbestos insulation from factory walls (if the insulation is not in need of repair) and replacing it with modern insulation material. This work does not constitute the rectification of a defect in a mechanical or physical sense as envisaged by section 25-10. The asbestos insulation functions efficiently as insulation. It is being replaced because of the health risk it might pose to factory occupants, not to 'repair' the factory in the ordinary sense of the word. The costs, if incurred on or after 19 August 1992, are deductible under subsection 82BK(1) of the ITAA 1936 as allowable environmental protection expenditure.

28. Another example of costs that are not deductible under section 25-10 is the cost of removing CFC gases from air conditioning plant and replacing them with non-ozone depleting gases. This work does not remedy any defect (in a mechanical or physical sense) in the holding, etc., of the air conditioning plant for income purposes, even though it is beneficial to public health. The costs, if incurred on or after 19 August 1992, are deductible under subsection 82BK(1) of the ITAA 1936 as allowable environmental protection expenditure.

29. Expenditure to control health risks associated with the use of dangerous substances that is not deductible under section 25-10 may be deductible under section 8-1 or Subdivision CA of Division 3 of Part III of the ITAA 1936.

30. The provisions of Subdivision CA (comprising sections 82BH to 82BR of the ITAA 1936) allow a deduction for expenditure, including

expenditure of a capital nature, incurred on or after 19 August 1992 by a taxpayer carrying on eligible environmental protection activities. These activities are the preventing, combating or rectifying pollution (which here means contamination of the environment by harmful or such potentially dangerous substances as asbestos and CFCs) in the circumstances specified in paragraph 82BM(1)(a) of the ITAA 1936, and the treating, cleaning up, removing or storing of waste in the circumstances specified in paragraph 82BM(1)(b) of that Act. The environmental protection provisions are provisions of last resort. If a deduction for environmental protection activities is allowable under another provision of the Act, the expenditure is not deductible under Subdivision CA (see subsection 82BL(3) of the ITAA 1936).

Repair expenditure of a capital nature

(Note: see explanation at paragraphs 108 to 112 and example at paragraph 164 of this Ruling)

In what situations is repair expenditure of a capital nature?

31. Expenditure incurred for repairs is not deductible under section 25-10 if the expenditure is of a capital nature. Subsection 25-10(3) precludes a deduction for capital expenditure.

32. Expenditure for repairs to property is capital expenditure if any of the following subparagraphs applies:

(a) The guidelines for distinguishing between capital and revenue outgoings laid down by the courts for the purposes of the forerunners of section 8-1 in such cases as *Sun Newspapers Ltd v. FC of T* (1938) 61 CLR 337; (1938) 5 ATD 87 and *Hallstroms Pty Ltd v. FC of T* (1946) 72 CLR 634; (1946) 8 ATD 190 indicate that the expenditure is incurred in establishing, replacing or enlarging the profit-yielding (i.e., business) structure rather being a working or operating expense (see also paragraphs 111 and 134 of this Ruling).

(b) The expenditure, rather than being for work done to restore the property 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 (see paragraph 114 of this Ruling for what is meant by an 'entirety'). 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 115 of this Ruling).

(c) If property 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 59 to 66 and 125 to 140 of this Ruling).

33. The cost of replacing things such as free-standing stoves, refrigerators and furniture in premises used for income purposes is capital expenditure and is not deductible under section 25-10. (Note, however, that these items (if they are not permanent fixtures) are plant on which depreciation is allowable: see Taxation Ruling IT 242.)

34. The cost of replacing items such as locks and exhaust fans, which are permanent fixtures installed in premises used for income purposes, is deductible as a repair under section 25-10 provided it is a replacement of a worn out unit by a new unit of a similar design that simply restores its efficiency of function and is not an improvement: see *Case S27* (1966) 17 TBRD 163; (1966) 13 CTBR (NS) *Case 56*.

No deduction for 'notional' repairs

35. If work done goes beyond 'repair' and the whole cost is capital expenditure, no amount is allowable as a deduction under section 25-10 for 'notional' repairs, i.e., an amount it is estimated that repair work would have cost the taxpayer if the property had in fact merely been repaired (but see paragraphs 55 to 57 of this Ruling for the deductibility of repairs carried out at the same time as an improvement, and paragraphs 63 to 66 and 136 to 140 of this Ruling for dissecting or apportioning initial repair costs).

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

(Note: see explanations at paragraphs 113 to 119 and examples at paragraphs 165 to 170 of this Ruling)

Repair is distinct from renewal or reconstruction

36. Repair is restoration by renewal or replacement of subsidiary parts of a whole. Renewal or reconstruction, as distinguished from repair, is restoration of the entirety.

What is an 'entirety'?

37. The term 'entirety' is used by the courts in repair cases to refer to something 'separately identifiable as a principal item of capital

equipment' (*Lindsay v. FC of T* (1960) 106 CLR 377 at 385; (1960) 12 ATD 197 at 201), 'a physical thing which satisfies a particular notion' (the *Lindsay* case at 106 CLR 384; 12 ATD 201) and 'not necessarily the whole but substantially the whole of the [property] under discussion' (the *Lindsay* case at 106 CLR 383-4; 12 ATD 200). 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 to be answered in the light of all the circumstances it is reasonable to take into account (see *Regent Oil Co Ltd v. Strick Inspector of Taxes* [1965] 3 All ER 174 at 179; *Brown (Inspector of Taxes) v. Burnley Football and Athletic Co Ltd* [1980] 3 All ER 244 at 255).

38. Property is more likely to be an entirety if:

- the property is separately identifiable as a principal item of capital equipment; or
- 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; or
- the thing or structure is a separate and distinct item of plant in itself from the thing or structure which it serves; or
- the thing or structure is a 'unit of property' as that expression is used in the depreciation deduction provisions of the income tax law.

39. Property is more likely to be a subsidiary part rather than an entirety if:

- it is an integral part of some larger item of plant; or
- the property is physically, commercially and functionally an inseparable part of something else.

40. Examples of property that constitute an entirety are a slipway on the business site of a slip proprietor and ship repairer (the *Lindsay* case); a spectators' grandstand in a football stadium (the *Burnley FC* case); a bridge giving access to the driveway of a garage (Case *B21* (1951) 2 TBRD 101); a substantially new race track (*Case D64* 72 ATC 390; (1972) 18 CTBR (NS) *Case 33*); and a factory drainage system comprising an underground system of concrete stormwater drains (*Case G5* (1955) 7 TBRD 29). Examples of property that do not constitute an entirety are the insulation and lining for a cool room (*Case T14* (1968) 18 TBRD 67) and a window in a factory (even though the window is totally restored). Something that is part of a

building, e.g., a roof or wall, is just that and no more. The building itself is the entirety.

41. If a series of separate buildings collectively form and function as a single industrial undertaking or commercial complex, we take the view that each separate building in the undertaking or complex is an entirety in itself. We do not accept that the whole undertaking or complex is an entirety. As a result, the replacement of a complete building is not regarded as replacement of a subsidiary part of an entirety comprised of the undertaking or complex.

42. Work done to a part of a building, though not amounting to a replacement or reconstruction of an entirety, may still be capital expenditure and not deductible, for example, because it amounts to an improvement: see (1953) 4 CTBR (NS) *Case 9* and paragraphs 44 to 57 of this Ruling for the distinction between a repair and an improvement.

Progressive restoration can involve deductible repairs

43. Although a reconstruction of the whole of property (e.g., fencing or a railway) is not a deductible repair, a series of restorations of the property could be undertaken over a period of time that progressively restores 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, scale and dimensions of the work in proportion to the nature, scale and dimensions of the property involved (the larger the work in comparison with the scale and dimensions of the property, the more likely a reconstruction of the entirety is 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 the work is done in accordance with an on-going program of restoration (more likely to constitute deductible repairs) or done in one operation (more likely to constitute a non-deductible reconstruction of the whole property).

Distinction between a repair and an improvement

(Note: see explanations at paragraphs 120 to 124 and examples at paragraphs 172 to 176 of this Ruling)

Repair is distinct from improvement

44. The meaning of 'repair' or 'repairs' is considered in paragraphs 12 to 30 of this Ruling. In the case of a 'repair', broadly speaking, the work restores the efficiency of function of the property without changing its character. 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 into a more valuable or desirable form, state or condition than a mere repair would do. Some factors that point to work done to property being an improvement include whether the work will extend the property's income producing ability, significantly enhance its saleability or market value or extend the property's expected life.

45. To distinguish between a 'repair' and an 'improvement' to property, one needs to consider the effect that the work done on **the property** has on its efficiency of function. This is the determinative test.

46. If the work entails the replacement or restoration of some defective, damaged or deteriorated part of the property, one does not focus on the effect the work has on the efficiency of function of **the part**. That is not determinative of whether the property is repaired or improved. It is a relevant factor to take into account, however, in considering the effect of the work on **the property's** efficiency of function. It is possible, for instance, that the replacement of a subsidiary part of property with a part better in some ways than the original is a repair to the property without the work being an improvement to the property.

47. Replacement or substantial reconstruction of the entirety, as distinct from the subsidiary parts of the whole, is an improvement.

Use of different materials

48. If expenditure is incurred in replacing or renewing a part of property with a material of a different type from the original, the work done may either repair the property, or be an improvement to it. The use of different materials is not in itself determinative of the issue.

49. Whether the use of a more modern material to replace the original material qualifies as a repair is a question determined on the facts of each case. It is restoration of a thing's efficiency of function

(without changing its character) rather than exact repetition of form or material that is significant.

50. If the work done restores a previous function to the property, or restores the efficiency of the previous function, it does not matter that a different material is used. Even if the work done using different material enables the property to perform its function marginally more efficiently, the work may still constitute a deductible repair. However, the greater the work enhances the efficient functioning of the property, the more likely it is that the work constitutes an improvement.

51. The test is whether there is a sufficient degree of improvement to justify characterising the expenditure as capital and therefore excluding it from deductibility under section 25-10.

52. If the work produces a new and different function, or an additional function, it is likely to constitute a capital improvement.

Technological advances or enhancements

53. As a general proposition, the greater the degree of technological advancement involved in work done to property, the more it is likely the work goes beyond a 'repair'. This is so because it is more likely the work does more than restore the property to its original efficiency of function. If it does, the cost of the work is not deductible under section 25-10. (It might be deductible under section 8-1 if the cost is a working or operating expense and it is not of a capital nature.)

54. If, however:

- (a) the work done to property involves:
  - (i) a degree of technological advancement that results in only a minor and incidental improvement to the property; or
  - (ii) an enhancement arising from the use of more modern materials and component parts (often where original materials and parts are no longer available) that adds in only a minor and incidental way to the overall efficiency of function of the property; and
- (b) the work done does not change the property's character;

this does not **in itself** preclude the expenditure from being characterised as repair expenditure deductible under section 25-10.

Repairs done at the same time as improvements

55. The character of a repair does not necessarily change because it is carried out at the same time as an improvement. If, for example, a

shopping centre is extensively renovated or restored (the project combining repairs and improvements) and if some parts of the project can be effectively separated and considered in isolation from the rest of the project, they may still be repairs. It is necessary to examine separately the individual parts of the total project to determine whether any part, if considered in isolation, is a repair. It is not appropriate to have regard only to the result of the entire 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 separated and characterised as repairs, and if their cost can be segregated and accurately quantified, their cost is deductible. It must be possible to segregate the cost of the repairs actually effected from the capital cost of the improvements.

56. If, however, repair work is inextricably bound up with work of an improvement nature, and the repair work cannot be separately segregated and its cost accurately quantified independently from the cost of the improvements, we regard the cost of the entire work as being of a capital nature and not deductible.

57. For example, if work normally regarded as a repair, such as painting, is done to property as part of, or in conjunction with, a reconstruction and modernisation of the property, and it cannot be segregated and its cost separately quantified, it may not be deductible. It is again a question of fact and degree.

58. Expenditure on 'notional' repairs is not deductible; see paragraph 35 of this Ruling.

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

(Note: see explanations at paragraphs 125 to 140 and examples at paragraphs 177 to 179 of this Ruling)

Initial repairs are of a capital nature and not deductible

59. Expenditure incurred on an initial repair after property is acquired, if the expenditure is incurred in remedying defects, damage or deterioration in existence at the date of acquisition, is capital expenditure and is not, therefore, deductible under section 25-10. This is so whether the property is purchased or obtained under lease or licence by the taxpayer. The cost of effecting an initial repair is still not deductible even if some income happens to be earned after acquisition but before the repair expenditure is incurred: but see paragraphs 63 to 66 of this Ruling in relation to dissecting or apportioning initial repair costs.

60. The main consideration in relation to initial repairs is the appearance, form, state and condition of the property and its functional efficiency when it is acquired. Expenditure that remedies some defect or damage to, or deterioration of, property is capital expenditure if the defect, damage or deterioration:

(a) existed at the time of acquisition of the property; and

(b) did not arise from the operations of the person who incurs the expenditure.

61. It is immaterial whether at the time of acquisition the taxpayer was aware of the condition of the property, including its need for repair. It is also immaterial whether the purchase price (or lease rentals) reflected the need for repairs. We consider that the English Court of Appeal decision in *Odeon Associated Theatres Ltd v. Jones (Inspector of Taxes)* [1972] 1 All ER 681 is not authority in Australia for a contrary view. An initial repair expense is not the type of repair expenditure ordinarily incurred as a working or operating 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 or an improvement in the quality of the property acquired. Initial repair expenditure relates to the establishment of the profit - yielding structure. It is capital expenditure and is not deductible under section 25-10.

Initial repairs to property obtained by lease or licence

62. If property is obtained under lease or licence (rather than purchased) and is, or is to be, held, etc., for income purposes, expenditure on 'initial repairs' is capital expenditure. Expenditure for initial repairs after property is obtained under lease or licence is therefore not deductible under section 25-10.

Initial repair costs can be dissected or apportioned

63. An initial repair expense can be dissected or apportioned to allow a deduction under section 25-10 of any part of the expense that remedies deterioration arising from the holding, etc., of the property by the taxpayer for income purposes after it was acquired. No dissection or apportionment is available, however, if the repair expenditure is necessitated by a defect or damage to property because this expenditure is either wholly attributable to the holding, etc., of the property before the taxpayer acquired it or wholly attributable to the

holding, etc., of the property by the taxpayer for income purposes after it was acquired.

64. Dissection or apportionment on a **time basis** is appropriate if repair costs are incurred either due to defects (whether expected or unexpected) that arise gradually over an extended period or due to wear and tear or deterioration that occurs:

(a) in part before the property is acquired by a taxpayer; and

(b) in part in the course of the taxpayer's holding, etc., of the property for income purposes.

65. This dissection may be done either in the year of income the property is acquired if the initial repair expenditure is incurred in that year or in a later year in which the expenditure is incurred.

66. If repair costs are attributable either to damage before property is acquired by a taxpayer, or to defects that emerged suddenly and matured by the time of acquisition of the property, no deduction is allowable under section 25-10 in accordance with paragraph 59 of this Ruling. If repair costs are attributable either to damage that occurs during the taxpayer's holding, etc., of the property for income purposes or to defects that emerge suddenly and mature during that time, a deduction is allowable if the other general principles stated in this Ruling are satisfied.

Some specific issues in construing section 25-10

(Note: see explanations at paragraphs 141 to 144 and examples at paragraphs 180 and 181 of this Ruling)

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

67. A taxpayer is entitled to a deduction under section 25-10 for expenditure for repairs to property he or she holds, etc., for income purposes, even though the taxpayer does not own the property. The test is whether the taxpayer held or used the property as required, not that the taxpayer owned the property.

68. A lessee of business premises, for example, is entitled to a deduction under section 25-10 for repair expenditure incurred in a year of income during the term of the lease if the lessee held, etc., the premises for income purposes when the expenditure is incurred. This is so even though the lessee does not own the premises and even if the year of income is the year that the lease expires, provided that, when the repair expenditure is incurred, the lessee held, etc., the premises for income purposes. A deduction is also allowable if a licence to use the business premises is granted to the taxpayer rather than a lease of the premises.

69. No deduction under section 25-10 is allowable to a real estate agent who incurs repair expenditure on a rental property on the agent's list. This is because a real estate agent does not hold, occupy or use a rental property for the purpose of producing assessable income or in carrying on business for that purpose. It is the owner or lessor of a rental property who holds or uses it for income purposes.

70. The deductibility under section 8-1 of costs incurred by a real estate industry employee on such things as replacing a cracked window and repairs to door locks in presenting a property for sale is considered in Taxation Ruling TR 95/21. Paragraphs 22 and 172 to 174 of TR 95/21 state that these costs are not deductible under subsection 51(1) of the ITAA 1936 because they are not incurred in deriving the employee's income. Rather, they are incurred in deriving the employer's income.

Expenditure for repairs must be 'incurred'

71. There need be no legal obligation on the taxpayer to undertake 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. The word 'incur' in section 25-10 has the same meaning as the word 'incurred' in section 8-1.

Property must be held or used bone fide for income purposes

72. You can deduct repair expenditure if, when you incurred the expenditure, you held or used the property bona fide for income purposes. We say 'bona fide' here because some arrangements may not result in an allowable deduction. For instance, a taxpayer's beachside apartment may have deteriorated over several years due to wear and tear arising from its use for private purposes. If the taxpayer arranges to 'rent' the apartment to his or her adult child for, say, a month and during that month incurs expenditure to repair and paint the apartment, a deduction may not be allowable, in our view, under section 25-10 for the repair and painting costs. We would take the view in appropriate circumstances that no deduction is allowable either because:

(a) the apartment is not held, etc., for income purposes; or

(b) Part IVA of the ITAA 1936, may apply to the arrangement.

Expenditure for repairs after property is held, etc., for income purposes but before income is actually derived

73. A deduction is allowable under section 25-10 for repair expenditure incurred in a year of income after property is first held, etc., for income purposes but before income is actually derived from the property, provided the repairs are not initial repairs. For example, a rental property may be vacant but be advertised as being available for rental. Before a tenant occupies the property, storm damage or an accidental breakage occurs. Expenditure incurred to repair the damage or breakage is deductible under section 25-10 because the property is held, etc., for income purposes.

Scope of repair deduction provision and general deduction provision

74. Generally speaking, section 8-1 produces the same result as section 25-10 in relation to the deductibility of repair costs. Section 8-1 has its own tests for deductibility. There may be occasions, however, where section 8-1 allows a deduction for repair expenditure that would otherwise not be deductible under section 25-10. Section 8-1 might allow a deduction, for example, after a taxpayer ceases to hold, etc., property for income purposes even though section 25-10 would not allow a deduction (see *Placer Pacific Management Pty Ltd v FC of T* 95 ATC 4459; (1995) 31 ATR 253).

Expenditure for repairs before property is held, etc., for income purposes

(Note: see explanations at paragraph 145 and example at paragraph 182 of this Ruling)

75. Repair expenditure incurred in a year of income before property is held, etc., for income purposes is not deductible under section 25-10.

Expenditure for repairs to property previously used by the taxpayer for non-income producing purposes

(Note: see explanations at paragraph 146 and examples at paragraphs 183 and 184 of this Ruling)

76. In appropriate circumstances, expenditure for repairs can qualify as a deduction even though the property has previously been held, etc., by the taxpayer for non-income purposes. This situation is different from an initial repair done to newly purchased or newly leased property, where the repair expenditure is capital expenditure.

77. A deduction is allowable under section 25-10 if, when the repair expenditure is incurred in a year of income, the property is held, etc., by a taxpayer for income purposes:

(a) even though the property has previously been held, etc., by the taxpayer for non-income purposes; and

(b) even though some or all of the defects, damage or deterioration arise from, or are attributable to, the taxpayer's holding, etc., of the property before its holding, etc., for income purposes; and

(c) provided that the repair expenditure is not capital expenditure.

Expenditure for repairs to property used for the purpose of providing non-deductible entertainment

(Note: see explanations at paragraphs 147 to 150 and example at paragraph 185 of this Ruling)

78. Deductions otherwise allowable under section 25-10 or under section 8-1 for repairs to property are reduced to the extent that the property, when the expenditure is incurred, is used by a taxpayer for the purpose of providing, or in connection with providing, entertainment that is made non-deductible by section 32-15 of the ITAA 1997 (or the former section 51AE of the ITAA 1936). The deduction is wholly denied if the property is used solely for non-deductible entertainment. If the property is used to provide both deductible and non-deductible entertainment, the deduction is proportionately reduced to the extent that the property is used for non-deductible entertainment.

Expenditure for repairs to property used only partly for income producing purposes during a year of income

(Note: see explanations at paragraphs 151 to 161 and examples at paragraphs 186 and 187 of this Ruling)

79. If property is held, etc., in a year of income partly for income purposes and partly for non-income purposes, repair expenditure is only deductible to the extent that is reasonable in the circumstances of the case. The reasonableness test is an objective one and each case must be decided on its own merits. However, we would expect that the amount of expenditure allowable as a deduction under subsection 25-10(2) (or the old law, when read with subsection 53(3)) would ordinarily be calculated by reference to the extent to which the property was held, etc., in the year of income for income purposes.

Date of effect

80. Subject to paragraphs 81 and 82, 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).

81. Paragraphs 26 to 30 of this Ruling (expenditure to control health risks from dangerous substances) may be less favourable in some circumstances than Taxation Ruling IT 2183. It is less favourable because IT 2183, broadly stated, accepted as deductible repair work done in controlling health risks associated with the use of asbestos in income producing buildings. Paragraphs 26 to 30 only have a future application. They only apply to expenditure incurred after the date of this Ruling.

82. Paragraphs 63 to 66 of this Ruling (initial repair costs can be dissected or apportioned) are more favourable to taxpayers than the Commissioner's earlier practice of denying any dissection or apportionment. Paragraphs 63 to 66 have both a past and future application, subject to the statutory limits of section 170 of the ITAA 1936.

Explanations

Meaning of the word 'repairs'

(Note: see ruling at paragraphs 12 to 30 and examples at paragraphs 162 and 163 of this Ruling)

Ordinary meaning of the word 'repairs' in its context in section 25-10

83. The word 'repairs' is not defined in the Act. In its context in section 25-10, 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.'

84. *Osborn's Concise Law Dictionary*, 8th ed, defines 'repair' as:

> 'The making good of defects in a property which has deteriorated from its original state. The work required may involve curing defects arising from the defective design or construction of the

> building, but it must fall short of effectively reconstructing the premises or improving them.'

85. Many judicial decisions make it plain that 'repair' involves the making good of defects, damage or deterioration including the renewal of parts and that the word does not imply a total reconstruction: see *Stroud's Judicial Dictionary*. In *BP Oil Refinery (Bulwer Island) Ltd v. FC of T* 92 ATC 4031 at 4039; (1992) 23 ATR 65 at 73, the Federal Court of Australia (Jenkinson J) expressed the opinion that 'work will not be considered repair unless it includes some restoration of something lost or damaged, whether function or substance or some other quality or characteristic'.

86. 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.'

87. What is a 'repair' for the purposes of section 25-10 is a question of fact and degree in each case having regard to the form, state and condition of the particular property and its functional efficiency when 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 of subsidiary parts to some degree and may involve improvement but only to a minor and incidental extent.

Restoration of efficiency of function of the property

88. The High Court of Australia (Windeyer J) said in *W Thomas & Co Pty Ltd v. FC of T* (1965) 115 CLR 58 at 72; (1965) 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 a 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)

89. It is therefore more significant in applying the word 'repairs' in its context in section 25-10, to consider whether the work restores the efficiency of function of the property for income purposes (without changing its character) than it is to consider whether the appearance, form, state or condition of the property is exactly restored.

Functionality of the property on which the work is done

90. In considering whether work does more than restore property to its original efficiency of function, what is determinative is the functionality of the property on which the work is being done and not the functionality of the defective component or part. That is not to say, however, that the effect of the work on the functionality of the defective component or part is not relevant. It is a relevant factor to take into account in considering the extent of change made to the functionality of the property.

91. To illustrate, if cast-iron pistons in an engine are replaced with aluminium-alloy pistons, being a more modern material for the construction of pistons, the determining question is whether the functionality of the engine has been restored or has only been enhanced in a minor and incidental way. However, any greater efficiency of function of the pistons is a relevant consideration in deciding that question. Expenditure in replacing the pistons is deductible under section 25-10. The engine's essential efficiency of function has not changed. Nor has the character of the engine changed by the use of marginally more efficient pistons. The aluminium-alloy pistons are marginally more efficient because they are lighter, hardier and are machined differently to produce less friction.

Maintenance work - whether 'repair'

92. Maintenance, as generally understood, includes the prevention of defects, damage or deterioration; a common example is the regular re-painting of business premises. The word 'maintenance' may in some contexts be the same as 'repair', and it may in some contexts have a wider meaning that includes repairing as well as other operations. Some kinds of maintenance work constitute 'repairs' in its context in section 25-10, for example, painting plant or business premises to rectify existing deterioration and to prevent further deterioration. Maintenance done to property 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 section 25-10.

93. 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)

94. His Honour's statement, by necessary implication, indicates that work done that is **only** in anticipation of forthcoming defects or deterioration does in fact cease to be repair work. Work done in anticipation of forthcoming defects or deterioration can be considered a 'repair' if it is done **in combination with** work of rectification: see the *BP Oil Refinery (Bulwer Island) Ltd* case at 92 ATC 4039; 23 ATR 73.

95. Oiling, brushing or cleaning something that 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 section 25-10: compare *London & North Eastern Ry. Co. v. Berriman* [1946] 1 All ER 255 at 267 and the *BP Oil Refinery (Bulwer Island) Ltd* case. (The cost of these operations may be deductible under section 8-1.)

Work done to meet requirements of regulatory bodies

96. To constitute a 'repair' for the purposes of section 25-10, work done to meet requirements of regulatory bodies must satisfy the general principles and the various factors discussed in this Ruling. Work done to repair property that also happens to meet the requirements of regulatory bodies is deductible under the section. However, work done **solely** to meet requirements of regulatory bodies is not a 'repair' for the purposes of the section.

97. A 'repair' for the purposes of section 25-10 is, fundamentally, work done to remedy or restore a defect in, damage to, or deterioration of, property in a mechanical or physical sense.

98. We take the view that 'repair' does not extend to a removal of any impediment to the holding, etc., of property for income purposes arising solely from regulatory requirements. This is clearly demonstrable if the property is otherwise functioning (in a mechanical or physical sense) as intended and, in that sense, is not in a state of disrepair.

99. If Government regulations, for instance, require something to be added to property (e.g., an automatic sprinkler system to a building or an air bag to a motor vehicle), work done to comply with this requirement does not constitute a repair because it is not work done to remedy or make good any defect, damage or deterioration in a mechanical or physical sense. In any event, this is likely to involve capital expenditure and be excluded from section 25-10.

Alternative view

100. We acknowledge that an alternative view exists whether work done to meet regulatory requirements constitutes a 'repair' under the terms of section 25-10.

101. If a regulatory body imposes a requirement to do work to property (say, a requirement relating to health, safety or for some other social utilitarian purpose), proponents of this view contend that, until the work is done, this is an impediment or defect in the property that can necessitate a 'repair' in terms of section 25-10.

102. The regulatory requirement, on this view, is arguably an impediment or defect in the efficient functioning of the property, and thus, in the holding, etc., of the property for income purposes. In an extreme case, non-compliance with the requirement may even require income producing activities to cease. This view advocates that expenditure to remedy the impediment is deductible under section 25-10.

103. If Government regulations, for instance, require that work be done to property to control health risks associated with the use of dangerous substances (such as asbestos, CFCs, chromium, dioxins, cyanide, pesticides and arsenic), the work done could qualify, on this view, as a 'repair' for the purposes of section 25-10.

104. We do not accept the correctness of this alternative view. As stated earlier, we take the view that removing an impediment to the holding, etc., of property for income purposes arising from regulatory requirements does not constitute 'repair' of a defect in, damage to, or deterioration of the property in the context required by section 25-10.

Technological advances or enhancements

105. In many a repair process, there is some improvement made to property as a result of technological advancements or more modern materials and component parts becoming available. The extent of this improvement is crucial in making a judgment about the deductibility of repair expenditure under section 25-10.

106. As a general proposition, the greater the degree of:

(a) technological advancement; or

(b) enhancement arising due to the use of more modern materials and component parts;

involved in the work done to property, the more likely it is that the work involves an improvement or a change in the character of the property rather than a repair.

107. If, however, only minor and incidental improvement is made to the overall efficiency of function of property as a result of technological advancement, or by reason of enhancements due to the use of more modern materials and component parts in the work done to the property, the repair expenditure remains deductible under section 25-10.

In what situations is repair expenditure of a capital nature?

(Note: see ruling at paragraphs 31 to 35 and example at paragraph 164 of this Ruling)

108. Subsection 25-10(3) excludes capital expenditure from being a deduction. Under the old law, expenditure of a capital nature was also excluded.

109. 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; (1952) 9 ATD 452 and the *Lindsay* case (affirmed on appeal at (1961) 106 CLR 377; 12 ATD 505).

110. In the *Western Suburbs Cinemas* 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 £3,000. 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. His Honour said at 86 CLR 105; 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. Federal Commissioner of Taxation)*. 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 ... . The truth is, I think, that the new ceiling was an improvement to a fixed capital asset and that its cost was a capital charge.'

111. In *Lindsay v. FC of T* (1960) 106 CLR 197; 12 ATD 505, 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; 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 characterize 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 L.J., in *Lurcott v. Wakely & Wheeler*; *Rhodesia Railways v. Collector of Income Tax, Bechuanaland*'.
>
> In order to determine whether an item of expenditure is to be held on general principles to be chargeable to income or capital account, it is of course necessary to distinguish between "the business entity, structure or organization set up or established for the earning of profit and the process by which such an organization operates to obtain regular returns by means of regular outlay" ... : *Sun Newspapers Ltd and Associated Newspapers Ltd. v. Federal Commissioner of Taxation* [(1938) 61 CLR 337 at pp 359, 360]. But where the question is whether expenditure has been for repairs, and for the purpose of deciding that question one asks what is the entirety which it is relevant to consider, one is looking not for a profit-earning structure or entity, as such, but for a physical thing which satisfies a particular notion.'

No deduction for notional repairs

112. In the *Western Suburbs Cinemas* case, Kitto J rejected an argument that, where an actual expenditure is not an allowable deduction, a notional expenditure may be. His Honour said at 86 CLR 107; 9 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.'

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

(Note: see ruling at paragraphs 36 to 43 and examples at paragraphs 165 to 170 of this Ruling)

Repair is distinct from renewal or replacement

113. Repairs to property may involve renewal or replacement of a subordinate part of the property. As Buckley LJ said in *Lurcott v. Wakely & Wheeler* [1911] 1 KB 905 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.'

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

What is an entirety?

115. The tests used by the courts and tribunals or suggested by commentators to identify an entirety - as distinct from a subsidiary part - include one or more of the following:

- is the property (e.g., a chimney) physically, commercially and functionally an inseparable part of an entirety (e.g., a factory)?: *Samuel Jones & Co (Devondale) Ltd v. Commissioners of Inland Revenue* (1951) 32 TC 513.
- is the property (e.g., a slipway) separately identifiable as a principal item of capital equipment?: *Lindsay's* case.
- is the thing or structure (e.g., a timber staircase) 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., a 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 (OS) 287.
- is the property 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; (1969) 15 ATD 215.

116. The leading Australian case in this area is the High Court decision in the *Lindsay* case where slip proprietors and ship repairers reconstructed one of two slipways. The taxpayers 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 that 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 of the ITAA 1936 because the slipway ought to be considered as an entirety by itself (at 106 CLR 385; 12 ATD 201):

> 'It is separately identifiable as a principal, and indeed *the* 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 abovementioned, 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 may be suggested to form part.'

117. 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 (at 115 CLR 66; 14 ATD 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 of the building.'

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

Progressive restoration can involve deductible repairs

119. It is a question of fact and degree whether a reconstruction is undertaken of the whole property (not deductible) or a series of restorations is embarked on over a period of time, progressively restoring subsidiary parts of the whole (deductible). In the *Lindsay* case, the expenditure on the slipway was regarded as a non-deductible expense for the reconstruction of an entirety. The expenditure would not become deductible by apportioning it into parts referable to different sections of the slipway. By contrast, in *The Rhodesia Railways Ltd and Others v. Commissioner of Taxes (Southern Rhodesia)* [1925] 1 SAf TC 133 the restoration of sections of a railway track was held not to be the reconstruction of an entirety.

Distinction between a repair and an improvement

(Note: see ruling at paragraphs 44 to 57 and examples at paragraphs 172 to 176 of this Ruling)

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

121. 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 being a repair.

122. It needs to be borne in mind that repairing property to some extent 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 determined on the facts of each case.

123. What is determinative of deductibility under section 25-10, if different material is used, is whether the work done restores the efficiency of function of the property (without changing its character), not whether the same material as the original is used. We accept that use of different material may result in a minor and incidental degree of improvement in the property but still only restore the efficiency of function of the property. If the degree of improvement is more than

minor and incidental, the expenditure is of a capital nature and not deductible under section 25-10.

124. Relevant considerations, consistently with the approach taken by the High Court in the *W Thomas & Co* case and the *Western Suburbs Cinemas* case, in distinguishing generally between a repair and an improvement, are:

(a) whether or not the thing replaced or renewed was a major and important part of the structure of the property (at 86 CLR 106; 9 ATD 454);

(b) whether the work performed did more than meet the need for restoration of efficiency of function (at 86 CLR 106; 9 ATD 454 and at 115 CLR 72; 14 ATD 87), bearing in mind that 'repair' involves a restoration of a thing to a condition it formerly had without changing its character;

(c) whether the thing was replaced with a new and better one (at 86 CLR 106; 9 ATD 454); 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 (at 86 CLR 106; 9 ATD 454).

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

(Note: see ruling at paragraphs 59 to 66 and examples at paragraphs 177 to 179 of this Ruling)

Initial repairs are of a capital nature and not deductible

125. 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 for income purposes in the way intended.

126. The leading Australian case in this area is the High Court decision in the *Thomas* case. There, Windeyer J held that the costs of repairing a roof, guttering, wall, basement floor and wooden floor and painting a building in the year of income it was acquired was expenditure of a capital nature.

127. His Honour said (at 115 CLR 72; 14 ATD 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 Session 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)

128. 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 (at 115 CLR 74; 14 ATD 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.'

129. 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.

130. More recently, the English Court of Appeal in *Odeon Associated Theatres v. Jones (Inspector of Taxes)* [1972] 1 All ER 681 held that expenditure of £7,969 incurred during the period 1948-56 (in respect of dilapidations which occurred before acquisition) on the Regal Cinema at Marble Arch, which was acquired for £240,000 in January 1945 in a somewhat run-down condition, was expenditure of a revenue character.

131. A key reason for the decision was that, although the cinema was in disrepair at the date it was acquired, this had no effect on the purchase price. The purchase price was not affected because there was a war-time prohibition on repairing cinemas, causing all cinemas to be in a similarly dilapidated condition. We take the view that the

decision in the *Odeon Theatres* case should not be followed in Australia.

Alternative view

132. It has been suggested, however, that the *Odeon Theatres* case supports the view that expenditure on initial repairs is deductible under section 25-10 and not excluded as capital expenditure. On this view, repair expenditure is deductible if the property acquired - though in a state of disrepair at the time of the acquisition - is suitable for use for income purposes and if the purchase price of the property is not affected by that state of disrepair.

133. Even if the *Odeon Theatres* case is authority in the United Kingdom for the proposition that expenditure on initial repairs is not capital expenditure if a property's state of disrepair did not affect its suitability for use or 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 more persuasive precedent of the High Court of Australia in the *W Thomas & Co* case. In our view, the decision in the *Odeon Theatres* case is not likely to be followed in Australia: see *Case D47* 72 ATC 272 per AM Donovan (Chairman) and RK Todd (Member) at 291; (1972) 18 CTBR (NS) *Case 14* at 102 and *Case V83* 88 ATC 580 per DJ Trowse (Member) at 583; *AAT Case 4371* (1988) 19 ATR 3540 at 3542. Since the *Odeon Theatres* case was decided in 1972 it has not been followed in Australia by former Taxation Board of Review No 2 (*Case D47*; *Case 14*) or by the Administrative Appeals Tribunal (*Case V83*; *AAT Case 4371*).

134. We believe it is important to recognise that the proposition that expenditure on initial repairs is capital expenditure is not some unique principle. There is no general proposition that initial repair costs are not deductible for income tax purposes. Rather, the proposition that initial repair costs are of a capital nature 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; (1938) 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 P5* (1963) 14 TBRD 14 at 25; (1963) 11 CTBR (NS) *Case 44* per RE O'Neill (Member) at 218; *Case R101* 84 ATC 673 per TJ McCarthy (Member) at 675; (1984) 27 CTBR (NS) *Case 154* at 1209 and *Case V83* 88 ATC 580 per DJ Trowse (Member) at 583; *AAT Case 4371* (1988) 19 ATR 3540 at 3542-3.

Initial repairs to property obtained by lease or licence

135. Expenditure for initial repairs after property is obtained under lease or licence is of a capital nature and is not deductible under section 25-10. Initial repair costs incurred on property after it is purchased relate to the establishment of the profit-yielding structure and are therefore of a capital nature; initial repair costs incurred on property after it is obtained under a lease or licence relate to the establishment of the profit-yielding structure and are also of a capital nature. Therefore, for the same reasons that initial repairs are not deductible after the purchase of property, we take the view that expenditure for initial repairs after property is obtained under lease or licence is not deductible under section 25-10. In (1956) 6 CTBR (NS) *Case 55*, Taxation Board of Review No 2 held that initial repair costs incurred by a weekly tenant of premises were of a capital nature and not deductible under section 51 or 53 of the ITAA 1936.

Initial repair costs can be dissected or apportioned

136. Subsection 25-10(3) states that you cannot deduct capital expenditure under section 25-10. The old law referred to expenditure incurred for repairs, **not being expenditure of a capital nature**. This, in our opinion, allowed apportionment. After property is acquired by a taxpayer, it may deteriorate more during the period it is held, etc., by the taxpayer for income purposes than it had deteriorated when it was acquired by the taxpayer. The cost of bringing the property back to the state of efficiency of function that it was in when acquired by the taxpayer is deductible as a repair **not of a capital nature**. In other words, provided that the whole of the expenditure is for repairs, some part of that expenditure may be of a capital nature and some part of it may be deductible.

137. Expenditure for repairs to recently acquired property is fully deductible only if it involves the remedying of defects, damage or deterioration wholly attributable to the period in which the property is held, etc., by the taxpayer for income purposes. If, on the other hand, the expenditure involves putting the property in order suitable for use or the cost of remedying defects, or restoring damage or deterioration existing at the time of purchase, it is of a capital nature and not deductible under the old law. As a general rule of thumb, but subject to the facts in each particular case, repairs effected soon after the purchase of property often rectify defects in, damage to, or deterioration present in the property at the time of purchase.

138. Initial repair expenses can be dissected or apportioned under section 25-10 to allow a deduction to the extent to which the repair work remedies defects, damage or deterioration arising from the

taxpayer's holding, etc., of the property for income purposes after it is acquired: see the *Law Shipping* case where the Special Commissioners allowed a deduction of £12,000 (out of a sum of £51,558 incurred on repairs) as being applicable to the period during which the company owned the ship. See also (1962) 10 CTBR (NS) *Case 84*; (1963) 11 CTBR (NS) *Case 63*; (1950) 1 CTBR (NS) *Case 18* and (1959) 8 CTBR (NS) *Case 137* in which purchased properties were repaired and Taxation Boards of Review allowed a portion of repair expenditure; contrast the views of Senior Member, Mr PM Roach, in *Case V167* 88 ATC 1107; *AAT Case 12* (1986) 18 ATR 3056 and *Case W7* 89 ATC 161; *AAT Case 4845* (1988) 20 ATR 3170.

139. We accept that Windeyer J in the *Thomas* case (at 115 CLR 74; 14 ATD 88) was saying nothing more than that there was insufficient evidence in relation to the items of expenditure he was considering in that particular case to permit him a basis of apportionment. Windeyer J was not saying categorically that apportionment is never possible. This approach is also suggested by his Honour citing with approval the decision in the *Law Shipping* case.

140. We accept, for example, that a court might agree to apportionment if a taxpayer is able to identify the extent to which repair expenditure is necessitated by deterioration arising after property is acquired and is attributable to the taxpayer's holding, etc., of the property for income purposes.

Some specific issues in construing section 25-10

(Note: see ruling at paragraphs 67 to 74 and examples at paragraphs 180 and 181 of this Ruling)

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

141. It is not a specific requirement of section 25-10, unlike section 42-15, that property be owned by the taxpayer.

142. Entitlement to a deduction under section 25-10 for expenditure incurred by a taxpayer for repairs to property depends on whether the taxpayer held or used the property for income purposes.

143. A lessee of premises, or a person granted a licence to use premises, is entitled to a deduction under section 25-10 for repair expenditure if the lessee or licensee meets these requirements, i.e., holds, or uses the premises for income purposes, even though he or she does not own the premises.

Expenditure for repairs must be 'incurred'

144. Section 25-10 requires that you 'incur' expenditure for repairs for it to be deductible. For this purpose, the word 'incur' in section 25-10 has the same meaning as that given by the courts to the word 'incurred' in subsection 51(1) of the ITAA 1936: *Case Q48* (1965) 15 TBRD 229. Broadly stated, to be 'incurred' there needs to be a presently existing pecuniary obligation in relation to the repairs that has become due, but not necessarily payable, at that time. The taxpayer must be definitively committed to the expenditure.

Expenditure for repairs before property is held, etc., for income purposes

(Note: see ruling at paragraph 75 and example at paragraph 182 of this Ruling)

145. Under section 25-10, a deduction is allowed for expenditure for repairs to property held, etc., for income purposes. Expenditure incurred in repairing property is not deductible if the property is not held, etc., nor ever has been held, etc., for income purposes. Furthermore, the expenditure is likely to be capital expenditure. If it is, the exception for capital expenditure operates to deny a deduction. As the Administrative Appeals Tribunal (Mr PM Roach, Senior Member) said in *Case V167* 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 to property previously used for non-income producing purposes

(Note: see ruling at paragraphs 76 and 77 and examples at paragraphs 183 and 184 of this Ruling)

146. Repair expenditure, incurred by a taxpayer in a year of income on property held, etc., in earlier years for non-income purposes, can qualify for deduction under section 25-10 if the property is held, etc., for income purposes when the repair expenditure is incurred: see *Case V167* 88 ATC 1107; *AAT Case 12* (1986) 18 ATR 3056 and *Case W7* 89 ATC 161; *AAT Case 4845* (1988) 20 ATR 3170.

Expenditure for repairs to property used for the purpose of providing non-deductible entertainment

(Note: see ruling at paragraph 78 and example at paragraph 185 of this Ruling)

147. If:

(a) expenditure is incurred by a taxpayer for repairs to property; and

(b) when the expenditure is incurred the property is being used by the taxpayer in providing entertainment;

no deduction is allowable under section 8-1 or section 25-10 for the repair expenditure to the extent that the property is used for non-deductible entertainment: see section 32-15 of the ITAA 1997, when read with section 32-5 of that Act (or the former section 51AE of the ITAA 1936).

148. By section 32-15, use of property by a taxpayer in providing entertainment (whether or not the property is also used for another purpose) is taken not to be for the purpose of producing assessable income if section 32-5 would prevent the taxpayer deducting a loss or outgoing if the taxpayer incurred it in providing the entertainment. No deduction is allowable for the repair expenditure, or it is proportionately reduced, because the property fails to satisfy the requirement that it be used for income producing purposes. Subsection 51AE(14) of the ITAA 1936 provided, in essence, the same result.

149. Entertainment means:

(a) entertainment by way of food, drink or recreation; or

(b) accommodation or travel to do with providing entertainment by way of food, drink or recreation: subsection 32-10(1) of the ITAA 1997.

150. You are taken by subsection 32-10(2) to provide entertainment even if business discussions or transactions occur.

Expenditure for repairs to property used only partly for income purposes during a year of income

(Note: see ruling at paragraph 79 and examples at paragraphs 186 and 187 of this Ruling)

151. Before considering the operation of subsection 25-10(2), which applies if you held or used property only **partly** for income purposes, it is necessary to review the history of subsection 53(3) of the ITAA 1936.

152. Expenditure on repairs incurred before 19 April 1984 (when subsection 53(3) was inserted into the ITAA 1936) was deductible in full so long as the property was used to some extent for income purposes: see *Case Q11* 83 ATC 41; (1983) 26 CTBR (NS) *Case 75* and *Case Q98* 83 ATC 487; (1983) 27 CTBR (NS) *Case 26*.

153. Subsection 53(3) was inserted to overcome this result. By that subsection, expenditure for repairs to property held, etc., only partly for income purposes was deductible to the extent that the Commissioner considered reasonable in the circumstances of the case. According to the explanatory memorandum accompanying Income Tax Assessment Amendment Bill (No 3) 1984, subsection 53(3) meant that expenditure for repairs attributable to private or domestic use, or to earning exempt income, was not allowable.

154. Subsection 53(3) allowed an apportionment of expenditure incurred by a taxpayer in a year of income for repairs to property held, etc., partly **in that year** for income purposes and partly for non-income purposes. The amount of the expenditure allowable was ordinarily an amount calculated by reference to the extent to which the property was held, etc., in the year of income for income purposes.

155. Apportionment of repair expenditure incurred in a year of income was not available, however, if the property had been held, etc., by a taxpayer in earlier years of income for purposes other than income purposes. We based this opinion on the legislative history of subsection 53(3) and, in particular, on the legislative intention to overcome the conclusions reached in *Case Q11*; *Case 75* and *Case Q98*; *Case 26*.

156. We took the view that the correct construction of subsection 53(3) required that the relevant percentage of business use of property in a year of income be calculated as a proportion of the total use of the property **in that year**. Once calculated for a particular year of income, the percentage was applied to the whole repair expenditure incurred in the year. This meant, for example, that if a motor vehicle was used in a year of income 70 percent of the time for business purposes and repair expenditure was incurred on the vehicle, 70 percent of the expenditure was properly allowable. This was the case if the repair expenditure was incurred following an accident, whether the accident happened while the vehicle was being used for business or for non-business purposes.

Alternative views

157. We acknowledge, but do not concede as producing a proper interpretation of subsection 53(3), the following alternative views.

View 1

158. If the accident referred to in paragraph 156 happened while the vehicle was being used for income purposes, 100 percent of the repair

costs were allowable. If the vehicle was being used for non-income purposes, 70 percent of the repair costs were allowable.

View 2

159. If the accident referred to above happened while the vehicle was being used for income purposes, 100 per cent of the repair costs were deductible. If the vehicle was being used for non-income purposes, no repair costs were allowable.

160. Turning to subsection 25-10(2), it broadly corresponds with subsection 53(3), except that the Commissioner's discretion to determine the amount of the deduction has been replaced with an objective test of what is reasonable in the circumstances. Apart from this exception, subsection 25-10(2) expresses the same ideas as subsection 53(3).

161. We take the same views, for the purpose of the objective test in subsection 25-10(2), as those stated in paragraphs 154 to 156 of this Ruling for the former subsection 53(3).

Examples

Meaning of the word 'repairs'

(Note: see ruling at paragraphs 12 to 30 and explanations at paragraphs 83 to 107 of this Ruling)

Example 1

162. Sam Tabernarius, a shopkeeper, decides to replace the awning of his shop with a more modern and aesthetic equivalent. The awning is in good condition before the work is done; there is nothing to be restored, no decayed or worn out parts to be renewed and nothing loose or detached which requires fixing. The expenditure involved is not for repairs - the awning being in good repair before the work was done - and no deduction is allowable under section 25-10 of the ITAA 1997.

Example 2

163. By January 1997, Widgets Pty Ltd has used a building for a manufacturing plant for many years. Widgets Pty Ltd discovers on testing for contaminants that insulation in the roof and walls contains dangerous levels of asbestos fibres. The contaminated insulation had been placed in the building by the previous owner. The company

immediately set about removing the insulation and replacing it with a safe alternative. Expenditure incurred by Widgets Pty Ltd in removing and replacing the insulation is not a 'repair' and not deductible under section 25-10. However, because the expenditure is incurred entirely for an environment protection activity, namely, removing pollution from a site on which the company carries on its income producing activities (subparagraph 82BM(1)(a)(ii) of the ITAA 1936), it is deductible under subsection 82BK(1) of that Act. The expenditure is not in respect of constructing an improvement to the building so subsection 82BN(1) of that Act does not preclude a deduction under the environment protection provisions.

Repair expenditure of a capital nature

(Note: see ruling at paragraphs 31 to 35 and explanations at paragraphs 108 to 112 of this Ruling)

Example 3

164. Elle Bashful uses her truck for income producing purposes. She replaces the truck's worn out petrol engine with a diesel engine with a much greater economy of operation. The engine is not an entirety but a subsidiary part of truck. However, the costs relate to an improvement of the truck because the replacement of the engine involved a significantly greater efficiency in the truck's function. The engine is a major and important part of the truck and is a new and better engine with considerable advantages over the old one, including the advantage that it reduces the likelihood of future repair bills. The costs are of a capital nature and are not deductible under section 25-10: cf (1953) 3 CTBR (NS) *Case 82*. A deduction for depreciation under section 42-15 may be allowable.

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

(Note: see ruling at paragraphs 36 to 43 and explanations at paragraphs 113 to 119 of this Ruling)

Example 4

165. 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, e.g., the fence on the northern boundary. Mr Agricola replaces the entire fencing surrounding his property.

166. Mr Fermier is entitled to claim a deduction for the cost of repairing his fencing under section 25-10. The entirety is the total

fencing so replacing the fences on the northern boundary is a replacement of a subsidiary part of the whole fencing: cf (1963) 11 CTBR (NS) *Case 44*.

167. However, Mr Agricola's expenditure is not deductible under section 25-10 because the whole fencing was replaced, making it a reconstruction of the entirety. The total fencing is not a subsidiary part of the rural property or of anything else. To replace entire fencing with new fencing is to replace one capital asset with another capital asset. The cost is therefore of a capital nature: cf (1962) 10 CTBR (NS) *Case 58*. Mr Agricola's fences are depreciable 'plant' (paragraph 42-18(1)(c) of the ITAA 1997 or the former subparagraph 54(2)(b)(i) of the ITAA 1936) and are deductible under section 42-15.

Replacement or substantial reconstruction of the entirety

Example 5

168. After recent bushfires the local State Electricity Authority inspects electricity poles on a number of properties. The Authority advises Mr Hogg, a pig farmer, that his electricity poles and overhead power lines are unsound, due to damage caused by the bushfires. To rectify the damage caused, he replaces these with underground cables. The cabling is a part of a larger system by which electricity is brought to the farm, distributed for use, and usage measured. Further, even though underground cables are better protected from future bushfires and storms, no greater efficiency of function of the electricity system is provided by the cables. Accordingly, the expenditure incurred by Mr Hogg is a repair, and deductible under section 25-10. If Mr Hogg had merely replaced the poles and cables, the expenditure incurred would also be a repair, and deductible accordingly. If the electricity connection is used for both domestic and business purposes, the deduction is limited by subsection 25-10(2) 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 subsection 20-20(2) of the ITAA 1997 to the extent to which the expenditure is an allowable deduction.)

169. Note that there is an alternative view that the circumstances of this example may, in fact, amount to the replacement of an 'entirety', or an improvement. Although the decision in this matter is a borderline one, we consider that, on balance, the marginally better view - in keeping with our longstanding position on this matter - is that the facts of this example amount to the making of a repair.

Example 6

170. Mr P Bowser owns a service station that 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 their 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 section 25-10: *Case 36* (1949) 15 TBRD (OS) 287.

'Notional' repairs

(Note: see ruling at paragraph 35 and explanations at paragraph 112 of this Ruling)

Example 7

171. Ken-the-Shopfitter runs a factory in a building in which the wooden floor needs repairing. The options are either to repair the old floor or to replace it with an entirely new one of steel and concrete. Ken decides to adopt the second option because it will save future repairs and because it has distinct advantages over the old wooden floor. By choosing the second option, Ken cannot claim a deduction as if he had simply repaired the wooden floor. His actual expenditure being capital, none of it is allowable as a repair.

Distinction between a repair and an improvement

Material used different from original material

(Note: see ruling at paragraphs 44 to 57 and explanations at paragraphs 120 to 124 of this Ruling)

Example 8

172. 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 functional efficiency (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 section 25-10: *Case T75* (1968) 18 TBRD 377; (1968) 14 CTBR (NS) *Case 40*.

Technological advances or enhancements

Example 9

173. Switched-On Pty Ltd decides, after controlling its furnace for 25 years with electro-mechanical switches and gauges, to replace them with computerised controls. The computerised controls perform the same function as the original controls. Electro-mechanical controls are no longer mass produced and, if made to order, would cost substantially more than the computerised controls. The degree of improvement in the efficiency of the furnace's function is only minor and incidental, its character has not changed and the operation and output of the furnace have not altered. The cost of replacing the controls is deductible under section 25-10 of the ITAA 1997.

Example 10

174. Wind Tunnel Pty Ltd has a malfunctioning vibration monitor for one of its blower fans. It replaces the old monitor with a digital monitor. The new monitor gives a more accurate reading than the old one but this is superfluous to the company's needs because it only needs to ensure that the blower operates within a certain vibration range. The facility for reading a precise vibration level is inherent in the digital technology used in the new monitor. The monitor involved no extra cost. The degree of improvement in the efficiency of the blower fan's function is only minor and incidental and its character, as a blower fan, has not changed. Bearing in mind that the additional capacity of the monitor exceeds the taxpayer's needs, and viewing the issue from the particular taxpayer's proposed use of the blower fan and monitor, the monitor's cost is deductible under section 25-10.

Example 11

175. Gurgler Pty Ltd needs to replace the impellor in a pump it has used for five years. A new impellor made from stainless steel would cost $8,000. If the original cast iron impellor is replaced with another cast iron one, it would cost about $4,000. The stainless steel impellor is chosen because it will provide improved functional efficiency for the pump. It will perform more efficiently as an impellor and will last three to four times longer than the cast iron type. The cost of the stainless steel impellor is not deductible under section 25-10 because:

(a) there is a substantial improvement in the functional efficiency of both the impellor and the pump;

(b) the impellor is a major and important structural part of the pump;

(c) the impellor is new and better than the original impellor; and

(d) the stainless steel impellor has considerable advantages over the old cast iron one, including the advantage that it reduces the likelihood of repair bills in the future.

Repairs and improvements effected concurrently

(Note: see ruling at paragraphs 55 to 57 of this Ruling)

Example 12

176. Tracey owns a factory. The council has advised her to repair faulty wiring, reposition existing electrical outlets and install new power points, mains and switchboards. Only part of the expenditure is incurred on repair work. Individual parts of the work 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 section 25-10, provided the costs can be segregated and accurately quantified. Tracey must be able to segregate the costs of repairing the wiring from the (capital) costs of the electrical improvements. Tracey is required by section 262A of the ITAA 1936 to keep records that explain all transactions and other acts she engages in that are relevant for any purpose of the income tax law. It is advisable for Tracey to seek separate quotes and to maintain separate accounts in relation to the costs of repairing the wiring and the cost of electrical improvements.

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

(Note: see ruling at paragraphs 59 to 66 and explanations at paragraphs 125 to 140 of this Ruling)

Example 13

177. William Infelix purchases a house that was ostensibly in good repair. To make it more attractive to prospective tenants, minor repairs and renovations are undertaken. The minor repairs and renovations are initial repairs. Their cost is of a capital nature and not deductible. During the course of these repairs and renovations, William discovers that the woodwork is seriously affected by the ravages of white ants.

178. 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.

179. The expenditure incurred in these circumstances to fix the white ant problem existing at the date of purchase is also of a capital nature. It is therefore not deductible under section 25-10. 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* (1944) 11 TBRD (OS) 202 and the *W Thomas & Co* case.

Some specific issues in construing section 25-10

(Note: see ruling at paragraphs 67 to 74 and explanations at paragraphs 141 to 144 of this Ruling)

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

Example 14

180. 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 the road.

Example 15

181. Maureen and Pam Cook conduct a restaurant business from premises 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 section 25-10.

Expenditure for repairs before property is held, etc., for income purposes

(Note: see ruling at paragraph 75 and explanations at paragraph 145 of this Ruling)

Example 16

182. Mary-Ellen Walton, 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 1996. To make it more attractive for prospective tenants, Mary-Ellen undertakes major repairs and renovations to the house between August 1996 and February 1997.

She places the house in the hands of a real estate agent on 15 March 1997 and lets the house to tenants on 1 April 1997. The costs of the repairs and renovations are not deductible under the old law. When the costs were incurred, Mary-Ellen was not holding or using the house to produce rental income. The costs are an expense in preparing the house for producing rent. They are of a capital nature.

Expenditure for repairs to property previously used for non-income producing purposes

(Note: see ruling at paragraphs 76 and 77 and explanations at paragraph 146 of this Ruling)

Example 17

183. Brenton Viator owns a motor vehicle that he bought in December 1992. On 1 July 1995 he applied for and got a job as a travelling salesperson and commenced to use his vehicle solely for income producing purposes. On 15 August 1996 Brenton incurs repair expenditure on the vehicle. The cost of the repairs is deductible under the old law because the costs were incurred in the 1996-97 year and, on 15 August 1996, the vehicle 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 18

184. A building has been owned by a tax exempt entity for a number of years. At the start of a new taxation year, the entity 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 section 25-10 even though some of the deterioration that is remedied is attributable to the period when the body was not taxable. Subdivision 57-G of Schedule 2D of the ITAA 1936 does not deny the deductions for the repairs.

Expenditure for repairs to property used for the purpose of providing non-deductible entertainment

(Note: see ruling at paragraph 78 and explanations at paragraphs 147 to 150 of this Ruling)

Example 19

185. Generous Co Ltd, a large accounting firm, uses a cruiser solely for the entertainment of its existing and prospective clients, business associates and staff by taking them on sightseeing river and ocean

cruises. The company incurs $10,000 in repairing deterioration of the cruiser due to normal operating wear and tear. No deduction is allowable under section 8-1 or under section 25-10 for the repair costs.

Expenditure for repairs to property used only partly for income producing purposes during a year of income

(Note: see ruling at paragraph 79 and explanations at paragraphs 151 to 161 of this Ruling)

Example 20

186. Josephine Telefix, a television repairer, owns a station wagon that is used for 70% business and 30% private purposes during the taxation year. Repair costs of $10,000 are incurred on the front panels, engine and computer system in the station wagon following a car accident during the running of the business. The full amount of the repair costs of $10,000 is not deductible under section 25-10. Because Josephine uses the station wagon for private and for business purposes, subsection 25-10(2) limits the amount of her deduction to that part of the expenditure that reasonably relates to the use of the station wagon for business purposes, namely, $7,000.

Example 21

187. Assume the facts in *Example 20* are unchanged except that the accident occurs while Josephine is using the station wagon driving to Church, i.e., for private purposes. We reject the view that no part of the repair costs is deductible under section 25-10. Because Josephine uses the station wagon for private and for business purposes, subsection 25-10(2) limits the amount of her deduction to that part of the expenditure that reasonably relates to the use of the station wagon for business purposes, namely, $7,000.

Detailed contents list

188. Below is a detailed list of the contents of this Ruling:

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ATO references
NO 97/9762-9
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subject references
- allowable deduction
- capital
- entertainment
- entirety
- environmental protection expenditure
- improvement
- initial repairs
- maintenance
- notional repairs
- reconstruction
- renewal
- renovation
- repair
- replacement
- restoration

legislative references
- ITAA36 51(1)
- ITAA36 51AE
- ITAA36 51AE(14)
- ITAA36 53
- ITAA36 53(1)
- ITAA36 53(3)
- ITAA36 54(1)
- ITAA36 54(2)(b)(i)
- ITAA36 82(1)
- ITAA36 82BH
- ITAA36 82BK(1)
- ITAA36 82BL(3)
- ITAA36 82BM(1)(a)
- ITAA36 82BM(1)(a)(ii)
- ITAA36 82BM(1)(b)
- ITAA36 82BN(1)
- ITAA36 82BR
- ITAA36 Pt IVA
- ITAA36 Subdiv 57-G Sch 2D
- ITAA97 8-1
- ITAA97 25-10
- ITAA97 25-10(1)
- ITAA97 25-10(2)
- ITAA97 32-5
- ITAA97 32-10(1)
- ITAA97 32-10(2)
- ITAA97 32-15
- ITAA97 42-15
- ITAA97 Div 43

case references
- BP Oil Refinery (Bulwer Island) Ltd v. FC of T 92 ATC 4031; (1992) 23 ATR 65
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