TD 2005/D18 - Income tax: is a government rebate received by a rental property owner an assessable recoupment under subsection 20-20(3) of the Income Tax Assessment Act 1997, where the owner is not carrying on a property rental business and receives the rebate for the purchase of a depreciating asset (for example an energy saving appliance) for use in the rental property?

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This document has been finalised by TD 2006/31.

Draft Taxation Determination

Income tax: is a government rebate received by a rental property owner an assessable recoupment under subsection 20-20(3) of the *Income Tax Assessment Act 1997*, where the owner is not carrying on a property rental business and receives the rebate for the purchase of a depreciating asset (for example an energy saving appliance) for use in the rental property?

Preamble

This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners as it is not a ruling for the purposes of Part IVAAA of the ***Taxation Administration Act 1953****. It is only final Taxation Determinations that represent authoritative statements by the Australian Taxation Office.*

1. Yes.

Explanation

2. All references in this determination are to the *Income Tax Assessment Act 1997* (ITAA 1997).

3. An amount a taxpayer has received is an assessable recoupment under subsection 20-20(3) if:

- it is not *income* under ordinary concepts or otherwise assessable;
- it is received as *recoupment* of a loss or outgoing (except by way of insurance or indemnity); and
- the taxpayer *can deduct an amount for the loss or outgoing* under a provision that is listed in section 20-30.

Income

4. A government rebate for an energy saving appliance purchased by a rental property owner for use in their rental property is not income under ordinary concepts. The rebate is not income derived from a business because the property owner is not carrying on a business of property rental.[1] Nor is the rebate properly classed as income from renting a property to a tenant.

5. Where a government rebate is a bounty or subsidy and is not assessable as ordinary income under section 6-5, it is assessable under section 15-10 if the amount is received in relation to carrying on a business. Although the government rebate received by the rental property owner is a bounty or subsidy, it is not assessable under section 15-10 because it is not received in relation to carrying on a business.

6. However, certain amounts received by way of insurance, indemnity or other recoupment are assessable under Subdivision 20-A if the amount is not income under ordinary concepts or otherwise assessable.

Recoupment

7. Recoupment of a loss or outgoing is defined in subsection 20-25(1) to include any kind of recoupment, reimbursement, recovery, refund, insurance or indemnity. It also includes a grant in respect of a loss or outgoing. The rental property owner in this case has incurred an outgoing on acquiring a depreciating asset and the government rebate was made available to offset part of the cost of that asset. The government rebate for the purchase of an energy efficient appliance is clearly a recoupment of the rental property owner's outgoing.

Can deduct an amount

8. Recoupment amounts (other than insurance or indemnity amounts) are assessable under subsection 20-20(3) only if the amount is received for certain deductible losses or outgoings that are listed in section 20-30. One of the deductions listed in section 20-30 is capital allowances under Division 40. Capital allowance deductions under Division 40 include the decline in value of depreciating assets[2] that are used for the purpose of producing assessable income. As a capital allowance deduction under Division 40 is available to a rental property owner for the decline in value of an energy saving appliance used in the rental property, a recoupment of the cost of the appliance is an assessable recoupment under subsection 20-20(3).

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[1] Refer to explanation paragraphs 15 to 21 in Taxation Ruling TR 93/32.

[2] See Taxation Ruling TR 2004/16 for the Commissioner's view on the extent to which there is plant in a residential rental property. This is relevant in determining whether a deduction is available under Division 40 (for depreciating assets) or under Division 43 (for capital works).

For the loss or outgoing

9. A fundamental requirement for an amount received to be an assessable recoupment within subsection 20-20(3) is that a taxpayer has deducted or can deduct an amount 'for the loss or outgoing' under a provision listed in section 20-30. In the case of a depreciating asset the 'loss or outgoing' that the taxpayer has subjected themselves to is the asset's cost and the amount that can be deducted is the decline in value. The use of the word 'for' in subsection 20-20(3) requires a connection between the deduction and the loss or outgoing. The objects clause in Division 40 explains that connection in providing a deduction for the cost of a depreciating asset, spread over the period that reflects the period in which the asset can be used to obtain benefits.[3] The amount representing the decline in value of a depreciating asset is the amount deducted for the outgoing on, or cost of, the depreciating asset. This, together with the wording of subsection 20-20(3) and section 20-30, makes it clear that capital allowance deductions under Division 40 are deductions for which recoupment can be assessable.

10. Further support for this view is found in the words of section 20-40. This provision provides the method statement for including an amount in assessable income where a taxpayer has received an assessable recoupment of a loss or outgoing 'for which you can deduct amounts over two or more income years'. These words clearly envisage deductions for decline in value. The example which follows section 20-40 adds further support to the argument. The example shows how the method statement applies to an assessable recoupment for the cost of a depreciating asset. It refers to the deduction for decline in value in a particular year as 'deductions for the loss or outgoing'.

When is the recoupment assessable?

11. If the rental property owner can deduct the whole of the cost of the energy saving appliance in a single income year as a capital allowance deduction, for example for certain assets that cost $300 or less,[4] the assessable recoupment is included in assessable income in the year of receipt to the extent it does not exceed the loss or outgoing.[5] Where the recoupment is received before the income year of a deduction, the assessable recoupment is treated as having been received in the deduction year.[6]

12. If the cost of an energy saving appliance is deductible under Division 40 over two or more income years, section 20-40 applies so that the total of assessable recoupments to be included in assessable income at a particular time is limited to the total amount of the loss or outgoing that can be or has been deducted at that time. Any part of an assessable recoupment that is not included in assessable income in the year of receipt because of this limit is assessable in later income years to the extent that further amounts are deductible under Division 40 for the appliance in the later income years.

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[3] Section 40-15.
[4] Subsection 40-80(2) provides that the decline in value for a year of an asset is its cost if, its cost is $300 or less; it is used for income producing purpose other than in a business; it is not part of a set the cost of which exceeds $300; and the total cost of that asset and other substantially identical assets does not exceed $300.
[5] Section 20-35.
[6] Subsection 20-35(3).

Alternative view

13. There is an alternative argument that recoupment of the cost of a depreciating asset is not an assessable recoupment under subsection 20-20(3). The argument is that a deduction for decline in value of a depreciating asset is not a deduction for a loss or outgoing. This view argues that the deduction which is provided for decline in value of a depreciating asset is worked out by reference to, but is not for, the cost of the depreciating asset. The tax law recognises that certain assets will lose value over the time that they are used. Rather than allow a deduction to be calculated to reflect the actual pattern of decline for each individual taxpayer's asset, the tax law allows a choice of two arbitrarily determined methods of working out decline in value (prime cast and diminishing value). Under either of these methods, it is argued, the taxpayer is merely being provided with a deduction in each year for an approximation of a decline in value which is not a deduction for the cost of the depreciating asset.

14. For the reasons outlined in paragraphs 9 and 10, this argument is rejected.

Example

15. *At the start of the 2004-05 income year, John installs a solar hot water system in his rental property for $3,450, excluding piping. John claims a deduction for the decline in value of the hot water system under Division 40 using the prime cost method and an effective life of 15 years. He can claim a deduction for decline in value of the solar hot water system under section 40-25 of $230 for the 2004-05 income year and each of the following 14 income years (being $3,450 × 365/365 × 100%/15).*

16. *In the 2004-05 income year, John applies for and receives a government rebate of $600 as recoupment of his expenditure on the solar hot water system. The amount received from the government is not ordinary income, and as it is not received in relation to carrying on a business it is not assessable under section 15-10. However, it is an assessable recoupment under subsection 20-20(3).*

17. *The deduction for the solar hot water system for the 2004-05 income year is $230, therefore $230 of the recoupment is assessable in the 2004-05 income year. The unassessed part of the recoupment is then available for inclusion in John's 2005-06 assessable income but only to the extent that the total of the amounts assessed do not exceed the total of the deductions for the solar hot water system up to that time. Therefore for the 2005-06 income year he claims a deduction of $230 for decline in value and includes a further amount of $230 as an assessable recoupment. Any unassessed recoupment is available for inclusion in later income years only so far as it has not already been assessed and only to the extent of John's total deductions to that time for the solar hot water system. This means that John would include an assessable recoupment of $140 for the 2006-07 income year.*

Date of effect

18. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Your comments

19. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date.

Due date: **29 July 2005**

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Commissioner of Taxation
29 June 2005

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 92/20; TR 93/32; TR 2004/16

Subject references:

- assessable recoupments
- decline in value
- landlord expenses
- rental expenses

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1997 6-5
- ITAA 1997 15-10
- ITAA 1997 Subdiv 20-A
- ITAA 1997 20-20(3)
- ITAA 1997 20-25(1)
- ITAA 1997 20-30
- ITAA 1997 20-35
- ITAA 1997 20-35(3)
- ITAA 1997 20-40
- ITAA 1997 Div 40
- ITAA 1997 40-15
- ITAA 1997 40-80(2)
- ITAA 1997 Div 43

ATO references

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