TD 2002/5 - Income tax: what is a 'distribution line' in the electricity distribution industry for the purposes of the expression 'depreciating assets' in section 40-100 of the Income Tax Assessment Act 1997 ?

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This document has changed over time. This is a consolidated version of the ruling which was published on *24 April 2002*

Australian Taxation Office

Taxation Determination

TD 2002/5

Taxation Determination

Income tax: what is a 'distribution line' in the electricity distribution industry for the purposes of the expression 'depreciating assets' in section 40-100 of the *Income Tax Assessment Act 1997?*

Preamble

The number, subject heading, date of effect and paragraphs of this Taxation Determination are a 'public ruling' for the purposes of Part IVAAA of the ***Taxation Administration Act 1953*** *and are legally binding on the Commissioner. The remainder of the Determination is administratively binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain how a Determination is legally or administratively binding.*

Date of effect

This Determination applies with effect from 1st of January 2002. This Determination does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of effect of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

1. A depreciating asset in the form of a distribution line comes into being when all its components have been assembled. An above ground electricity distribution line incorporates conductors, cross arms, insulators and fittings, concrete, wood, steel or stobie poles, and (where relevant) a pole or ground pad mounted transformer or transformers. An underground electricity distribution line incorporates cables, fittings, and (where relevant) a ground pad mounted transformer or transformers. In keeping with the policy intent that 'deductions based on effective life are intended to reflect an appropriate allowance for the diminution of economic value of an asset over its period of use' (paragraph 22 of TR 2000/18), it is necessary to delimit a distribution line as a depreciating asset at the time it is first used or installed ready for use ('its start time'). The components that make up the new distribution line at its start time identify the limits of that distribution line.

2. The background to this issue is as follows:

- The Commissioner may make a written determination specifying the effective life of a depreciating asset: subsection 40-100(1) of the *Income Tax Assessment Act 1997* (ITAA 1997).
- The Commissioner is to make a determination of the effective life of a depreciating asset by estimating the period (in years, including fractions of years) it can be used by any entity for a taxable purpose or for the purpose of producing exempt income:

(a) assuming it will be subject to wear and tear at a rate that is reasonable for the Commissioner to assume;

(b) assuming it will be maintained in reasonably good order and condition; and

(c) having regard to the period within which it is likely to be scrapped, sold for no more than scrap value or abandoned: subsection 40-100(4) of the ITAA 1997.

- Taxation Ruling TR 2000/18 discusses the methodology used by the Commissioner in making a determination of the effective life of a depreciating asset.
- The Commissioner has made determinations specifying the effective life of electricity supply industry assets.
- Those determinations include the following entries:

Distribution lines:
Above ground (incorporating conductors; cross arms, insulators and fittings; poles – concrete, wood, steel or stobie; and transformers – pole or ground pad mounted)
Combination of above ground and underground
Underground (incorporating cables, fittings and ground pad mounted transformers)

3. The principles set out in paragraph 1 above are based on a consideration of whether a particular composite item is itself a depreciating asset or whether its components are separate depreciating assets: subsection 40-30(4) of the ITAA 1997. The legislation specifies that this is a question of fact and degree which can only be determined in light of all the circumstances of the particular case. How taxpayers determine that question is discussed in paragraph 1.15 of the revised explanatory memorandum for the New Business Tax System (Capital Allowances) Bill 2001 (which, as enacted, inserted the current Division 40 of the ITAA 1997). That paragraph states:

> *'Taxpayers will be required to exercise judgement in identifying the depreciating asset where the asset itself is made up of different parts and components. In doing this, the "functionality" test that is used as a basis of identifying a "unit of plant" in the existing plant depreciation rules can be used. (Specific reference to a "unit" or an "item" is not necessary to attract the test, as the definition of a depreciating asset is based on a life in effective use, and the depreciating asset must be identifiable as having its own life in such use.)'*

4. The 'functionality' test has been applied in such cases as *Ready Mixed Concrete (Vic) Pty Ltd v. FC of T* 69 ATC 4038; (1969) 1 ATR 123, *FC of T v. Tully Co-operative Sugar Milling Assoc Ltd.* 83 ATC 4495; (1983) 14 ATR 495, *Monier Colourtile Pty Ltd v. FC of T* 84 ATC 4846; (1984) 15 ATR 1256, *Case S51* 85 ATC 380; 28 CTBR (NS) Case 57, and *Case T33* 86 ATC 293; 29 CTBR (NS) Case 35.

5. Each of the following examples is simply intended to show how the principles set out in the preceding paragraphs apply to particular factual circumstances relating to distribution lines. The examples in no way modify how the general principles apply. Each situation must be looked at separately, with the general principles being applied to each set of facts.

Example 1 – An electricity distribution network owner builds a distribution line or an addition to an existing distribution line to supply customers who were not previously supplied by the network.

6. In both cases there is the addition of a distribution line which is a new and separate depreciating asset from any existing distribution infrastructure. A new depreciating asset in the form of a distribution line comes into being when all its components have been assembled: see the example of the erection of a farm fence in *Tully* per Lockhart J at ATC 4504; ATR 505. The function of the new distribution line is to provide electricity to the customers who are connected to the network by the addition. The new distribution line is capable of being separately identified or regarded as having a separate function from any existing distribution infrastructure; it performs a definable identifiable function; and it does not matter that the new distribution line may be incapable of independent operation without connection to an existing distribution line: see *Ready Mixed Concrete*, *Tully* and *Monier Colourtile*.

7. It is in keeping with the policy intent referred to above that the cost of the new distribution line be written off over that line's effective life rather than over the effective life of any pre-existing distribution line which may have come into being at a considerably earlier time.

Example 2 – An electricity distribution network owner replaces a pole in a distribution line. This might occur either due to unexpected damage (e.g., pole destroyed by a car or a storm) or due to normal wear and tear (e.g., wood pole that has rotted over time).

8. We consider that the replacement of a pole does not create a new depreciating asset separate from the distribution line of which it is a part. There has been no substantial alteration to the function of the distribution line of which the relevant pole is a part: see *Tully*, *Case S51* and *Case T33*.

Example 3 - An electricity distribution network owner upgrades a pole mounted transformer which forms part of an existing distribution line. The upgrade will increase the performance of the transformer. The upgrade may be required for various reasons (e.g., to deal with higher load).

9. We consider that the upgrade of an existing pole mounted transformer does not so substantially alter the function of the distribution line of which it is a part that a new depreciating asset is created: see *Tully*, *Case S51* and *Case T33*. The upgrade represents a capital improvement which is likely to be included in the second element of cost of the distribution line of which the transformer is a part: see section 40-190 of the ITAA 1997.

Commissioner of Taxation
24 April 2002

Previous draft:
Previously released as TD 2001/D16

Related Rulings/Determinations
TR 2000/18

Subject references:
- Commissioner's determination of effective life

- Commissioner's effective life schedule
- depreciating asset
- depreciation
- effective life
- electricity infrastructure

Legislative references:

- ITAA 1997 Div 40
- ITAA 1997 40-30(4)
- ITAA 1997 40-100(1)
- ITAA 1997 40-100(4)
- ITAA 1997 40-190
- TAA 1953 Pt IVAAA

Case references:

- Ready Mixed Concrete (Vic) Pty Ltd v. FC of T 69 ATC 4038; (1969) 1 ATR 123
- FC of T v. Tully Co-operative Sugar Milling Assoc. Ltd. 83 ATC 4495; (1983) 14 ATR 495
- Monier Colourtile Pty Ltd v. FC of T 84 ATC 4846; (1984) 15 ATR 1256
- *Case S51* 85 ATC 380; 28 CTBR (NS) Case 57
- *Case T33* 86 ATC 293; 29 CTBR (NS) Case 35

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