TD 93/189 - Income tax: can the cost of plant purchased for a specific project, and fully charged to the client, but which is still held after that project was completed and able to be used again, be treated as fully deductible under subsection 51(1) or under the depreciation provisions of the Income Tax Assessment Act 1936?

This document has changed over time. This is a consolidated version of the ruling which was published on *30 September 1993*

Taxation Determination

Income tax: can the cost of plant purchased for a specific project, and fully charged to the client, but which is still held after that project was completed and able to be used again, be treated as fully deductible under subsection 51(1) or under the depreciation provisions of the *Income Tax Assessment Act 1936*?

1. Subsection 51(1) precludes from allowing as a deduction expenditure on items, interalia, of capital or of a capital nature (*Sun Newspapers v FC of T* (1938) 61 CLR 337, 5 ATD 87). Plant is normally included in this category of expenses and therefore any underlying expenditure is not deductible under the section.

2. Subsection 54(1) allows depreciation on any property, being plant or articles owned by the taxpayer which during the year of income has been either:

a) used by the taxpayer for the purpose of producing assessable income; or
b) installed ready for use for that purpose and held in reserve.

3. From 1 July 1991, section 54A allows the taxpayer to make an estimate of the effective life of depreciable property acquired after 12 March 1991. Furthermore, under subsection 55(2), if the effective life of the property is less than 3 years, or the initial cost does not exceed $300, the depreciation rate is 100% for plant acquired after 1 July 1991, unless the taxpayer nominates a depreciation rate of less than 100%. (The new depreciation provisions, including factors pertinent to the issue of determining the effective life of a unit of property, applicable to the 1991/92 and subsequent financial years are discussed in detail in IT 2685.)

4. Subsection 59(1) provides that where depreciable property is disposed of, lost or destroyed any time in the year of income the amount by which the consideration receivable is less than the property's depreciated value shall be an allowable deduction in that year of income. In effect, in some circumstances (see Example 1), the taxpayer can claim as an allowable deduction 100% of the cost of plant in the year of income. One part of this deduction would be deductible under section 54 (i.e. depreciation) and the other under section 59 (i.e. balancing charge).

5. If it can be demonstrated that further use of the plant is not possible then it may be accepted that the plant has been disposed of or destroyed (*Henty House Pty Ltd v FC of T* (1953) 88 CLR 141, 10 ATD 231; 14 CTBR (NS) *Case 71,* (1968) 18 TBRD *Case No T63).* If plant purchased for a specific project is held by the taxpayer after the project has been completed and is able to be used again, the requirements of section 59 are not met and section 54 could still apply.

6. The fact that the cost of depreciable property had been charged to the client and included in the taxable income of the taxpayer is irrelevant for deciding the deductibility of the expense incurred on acquisition of that property. An expenditure can only be allowed as a tax deduction when it conforms to the provisions of the Act governing its deductibility. The character of the expenditure should never be confused with the character of the receipt associated with that expenditure (*GP International Pipecoaters Pty Ltd v FC of T* 90 ATC 4413, 21 ATR 1).

Example 1:
A mineral testing laboratory acquired a custom made plastic 60kg attritioning unit required for a specific mineral sand pilot plant testing on 1 January 1990. The cost of the unit was $5 000. The testing program was completed within 2 months after which the unit became obsolete. The unit was taken to the local rubbish tip and documentary evidence of the disposal obtained. The $5 000 paid for the unit was included in arriving at the fee charged to the client.

The taxpayer was entitled to claim depreciation of $125, calculated as 15% @ $5 000 for 2 months, in its 1990 return. It was also entitled to claim $4 875 loss as balancing charge on the unit's disposal.

Example 2:
On 1 January 1988 a mineral testing laboratory acquired for $5 000 a standard flotation cell for a specific gold ore testing program. The testing program was completed within 2 months. The $5 000 paid for the unit was a part of the fee charged to the client. The cost of the unit was claimed under subsection 51(1) in the 1988 return. After the project was completed the unit remained at the taxpayer's premises and it could be used for testing again. The taxpayer maintained that the unit had not been used since the 1988 year and was considered to be scrap.

The 1988 year claim for a deduction of $5 000 was disallowed because the criteria of sections 51 and 59 were not satisfied. The underlying expense was treated as capital or of a capital nature and thus not allowable pursuant to the provisions of subsection 51(1). As the unit was still on hand and had not been rendered inoperative section 59 had no application. The taxpayer was entitled to claim depreciation at the appropriate rate for the whole of the period the unit was in its possession and ready for further use under section 54.

Commissioner of Taxation
30/9/93

FOI INDEX DETAIL: Reference No. I 1216211 Previously issued as Draft TD 93/D139

Related Rulings: Income Tax Order 1217, IT 2685

Subject Ref: plant, deductibility, depreciation, cost recovery

Legislative Ref: ITAA 51(1); ITAA 54(1); ITAA 54A; ITAA 55(2); ITAA 59(1); ITAA 59(2A)

Case Ref: Sun Newspapers v FC of T (1938) 61 CLR 337, 5 ATD 87; Henty House Pty Ltd v FC of T (1953) 88 CLR 141, 10 ATD 231; 14 CTBR (NS) Case 71, (1968) 18 TBRD Case No T63; GP International Pipecoaters Pty Ltd v FC of T 90 ATC 4413, 21 ATR 1

ATO Ref: NOR J36/355/8ISSN 1038 - 8982

ISSN 1038 - 8982