TR 1999/12 - Income tax: deductibility of expenses incurred in preparing for the commencement of the Goods and Services Tax (GST)

Taxation Ruling
Income tax: deductibility of expenses incurred in preparing for the commencement of the Goods and Services Tax (GST)

Contents Para

Preamble

The number, subject heading, ***Class of person/arrangement****,* ***Ruling*** *and* ***Date of effect*** *parts of this document are a 'public ruling' for the purposes of Part IVAAA of the* ***Taxation Administration Act 1953*** *and are legally binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain 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 examines the expenses that may be incurred by taxpayers carrying on a business in preparing for the commencement of the Goods and Services Tax (GST) and explains the circumstances and the extent to which these expenses are deductible under the *Income Tax Assessment Act 1997* ('the ITAA 1997') or the *Income Tax Assessment Act 1936* ('the ITAA 1936').

2. The Ruling does not deal with the deductibility of the GST itself or transitional costs such as valuing construction contracts and costs relating to the impact of the GST in contracts that span 1 July 2000.

Ruling

Revenue expenses

3. A deduction is allowable for expenditure of a revenue nature that businesses may incur in gearing up for the GST. Revenue expenditure that qualifies for an immediate deduction would include new stationery, professional advice on complying with GST obligations and training and hiring staff.

Capital expenditure on plant

4. Expenditure incurred on new plant, such as computers, tills, scanners and similar items, is not deductible in the year the expenditure is incurred, unless the amount of the expenditure is $300 or less or the effective life of the item is less than 3 years.
A deduction for depreciation is allowable over the effective life of the item from the date the plant is used or installed ready for use.

Expenditure on computer software

5. Expenditure incurred in acquiring, developing or commissioning computer software is not deductible in the year the expenditure is incurred, unless the amount of the expenditure is $300 or less. The cost of software is depreciable over 2½ years at the rate of 40% per annum from the date the plant is used or installed ready for use.

Date of effect

6. This Ruling applies to years commencing both before and after the date of issue. However, the Ruling 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 issue of the Ruling (see paragraph 21 and 22 of Taxation Ruling TR 92/20).

Explanations

7. Developing and implementing new business practices and procedures to comply with new laws that affect the day-to-day operations of a business are an essential part of carrying on the business. Where a business is carried on for the purposes of producing assessable income, expenditure incurred in making changes to business activities required by the new laws are deductible under section 8-1 of the ITAA 1997, unless the expenditure is of a capital or private nature or is incurred in gaining or producing exempt income.

8. Businesses need to be prepared to comply with their obligations under the GST law when it commences on 1 July 2000. Whether the expenses incurred in gearing up for the GST qualify for an immediate deduction in the income year in which they are incurred depends on whether they are of a revenue or capital nature. In determining whether such expenditure is of a revenue or capital nature, the principles provided in *Sun Newspapers Ltd and Associated*

Newspapers Ltd v. FCT (1938) 61 CLR 337; 1 AITR 403 are particularly relevant.

Revenue expenses

9. Expenses of a revenue nature which businesses may incur in gearing up for the GST that would qualify for an immediate deduction are:

- costs of printing new stationery to show the business's ABN and redesigning invoices and perhaps other documents to provide for the GST;
- costs incurred in complying with registration formalities, such as professional fees for advice on completing the registration form;
- costs of professional advice obtained on developing and implementing new practices and procedures that need to be put in place to enable the business to comply with its obligation under the GST law;
- costs of training staff in the new practices and procedures required by the GST law; and
- costs of hiring new staff and the cost of termination payments made to staff who are made redundant as a result of efficiencies introduced in the course of changes made to prepare for the GST.

Capital expenditure

10. Many businesses may need to acquire new items of plant, such as computer hardware, cash registers, and new software to be able to fulfil their obligations under the GST law.

Computer hardware

11. Expenditure on new computers, tills, scanners and similar items is of a capital nature and is not normally deductible in the year the expenditure is incurred. These items are plant and qualify for a deduction for depreciation allowable over the effective life of the item (section 42-25) from the date the plant is used or installed ready for use (paragraph 42-15(b)).

12. If the cost of the item is not more than $300 or the item has an effective life of less than 3 years, a deduction for the cost of the item is allowable in the income year in which the expenditure is incurred (sections 42-130 and 42-125, respectively).

13. If a taxpayer adopts the effective life determined by the Commissioner rather than the taxpayer's own estimate of effective life, depreciation is allowable on computer equipment at the rate of 27% prime cost or 40% on a diminishing value basis. The depreciation rate for general cash registers is 17% prime cost or 25% on a diminishing value basis and 20% prime cost or 30% on a diminishing value basis for programmable or multifunctional cash registers.

Computer software

14. Expenditure incurred in acquiring, developing or commissioning computer software is depreciable over 2½ years on a prime cost basis of 40% per year (sections 46-25, 46-35 and 46-45). An immediate deduction is allowable for expenditure incurred on software purchases of $300 or less, provided the total cost of identical software does not exceed $300 in an income year (section 46-65).

15. However, if the expenditure incurred in acquiring, developing or commissioning computer software (including upgrades) is for the principal purpose of ensuring Year 2000 (Y2K) compliance, and that expenditure is incurred before 1 January 2000, an immediate deduction is allowable (subsection 46-75(1)). Where the principal purpose of the expenditure incurred before that date is not to ensure Y2K compliance, an immediate deduction is allowable only to the extent to which the expenditure is for the purpose of ensuring Y2K compliance (subsection 46-75(2)).

16. The deduction for depreciation of plant and software is allowable from the time it is installed ready for use, even though it cannot be used until the GST begins on 1 July 2000 (paragraph 42-15(b) and section 46-25).

Computer upgrades

17. Businesses may incur expenditure on upgrading existing computer systems primarily to enable the business to better comply with its GST obligations. If an upgrade to a business's existing computer system is in the nature of a repair, the expenditure is deductible in the income year in which it is incurred (subsection 25-10(1)). If the upgrade amounts to capital expenditure, the expenditure is depreciable over the remaining effective life of the asset.

18. Repair 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. 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.

19. Computer upgrades improve the functionality of a computer and therefore do more than merely make good damage or deterioration that has occurred by ordinary wear and tear. They improve the capacity of the computer and enable it to perform functions it was not previously capable of. Such upgrades are improvements and therefore of a capital nature.

Training and training packages

20. In preparation for the commencement of the GST, a business may acquire a training package as part of a new computer system and software. These training packages may include backup support and advice for a specified period. Expenditure for training staff in the use of new equipment and software applications that will be used in the day-to-day operations of the business is incurred in carrying on the business and is therefore deductible under section 8-1. Similarly, the proportion of any computer package for the provision of support services is deductible under section 8-1 in the income year in which the expenditure is incurred.

21. Where a business acquires a computer package comprising hardware, software, training and support for a single price, it is necessary to allocate a proportion of the purchase price among the different items. As expenditure on training and support is of a revenue nature and deductible in the income year it is incurred, a single amount may be allocated to these items. However, it is necessary to allocate the amount of the purchase price that is attributable to the computer equipment and that which is attributable to the software.

22. The Commissioner accepts any reasonable basis for allocating the cost of the different components that attract a different tax treatment. For example, if the combined cost of the package is less than it would have been if the items had been acquired separately, a reasonable basis for apportioning the cost of each component in the package would be on a pro rata basis.

Accounting systems

23. A business may take the opportunity presented by the introduction of the GST to review completely its current accounting systems. It may engage consultants or project managers, hire new employees or allocate existing employees to carry out this work. In broad terms, such a project would involve work to determine the

needs a new system would have to meet. It might also require an evaluation of the existing system to see whether it was capable of being modified to meet the revised requirements or whether it should be scrapped.

24. Maintaining an effective accounting system that provides the information necessary for a business to make day-to-day management decisions, to ascertain its financial position, to prepare taxation returns and to comply with regulatory requirements is an essential element of carrying on a business for the purpose of gaining or producing assessable income.

25. Expenditure (other than capital expenditure) incurred in operating the accounting system, monitoring the effectiveness of the system, making changes to ensure the system is operating effectively is deductible under section 8-1. Expenditure on new equipment to operate an accounting system would be of a capital nature. If the expenditure is to acquire plant, a deduction for depreciation is allowable.

Study tours

26. The effect of the introduction of the GST on some businesses may be such that the business considers its needs are so special that travel to a country which already has a similar type of tax may be necessary to study what changes it needs to make to prepare for the GST. The cost of such overseas travel qualifies for deduction under section 8-1 to the extent the expenditure is attributable to business purposes.

27. Where the overseas travel costs include travel for private purposes, the Commissioner apportions the expenses, applying the principles set out in relation to overseas travel in Taxation Ruling TR 98/9 (Income tax: deductibility of self education expenses).

Stocktakes

28. At the time of the introduction of the GST, many businesses will be holding inventories of new goods for sale on which wholesale sales tax has been paid. Businesses are be able to claim a special GST credit for the wholesale sales tax paid on the stock. As this special GST credit can only be claimed in respect of stock on hand at the start of 1 July 2000 that is held for sale or exchange in the ordinary course of business, businesses may need to conduct a stocktake at the close of business on 30 June 2000 to obtain that credit. The costs of conducting the stocktake are incurred in operating the businesses and are deductible under section 8-1.

Examples

29. A business decides to upgrade its computer system to become electronic commerce capable. It upgrades its present computer system at a cost of $2,000, buys new software for a cost of $5,000 and a modem for $280 and subscribes to an internet provider for a fee of $50 per month.

30. Deductions are allowable as follows:

- Computer upgrade –
  depreciation 27% (prime cost) of $2,000
  = $540 (full year).
- New software –
  depreciation 40% of cost of $5,000
  = $2,000 (full year).
- Modem –
  immediate deduction - $280
  (cost not more than $300).
- Internet subscription for 1 year –
  12 x $50 = $600.

31. If the computer upgrade and new software are acquired on 1 May 2000 and held in reserve until 1 July 2000, a deduction would be allowable in the 1999-2000 income year for 1/6 of the depreciation allowable for a full year.

Detailed contents list

32. Below is a detailed contents list for this Ruling:

Commissioner of Taxation
20 August 1999

Previous draft:

Not previously released to the public in draft form

Related Rulings/Determinations:

IT 2685; TR 97/23; TR 98/9; TR 98/13

Subject references:

- Australian Business Number
- accounting expenses
- accounting methods
- capital expenditure
- carrying on a business
- closing stock
- computer software
- computer hardware
- computers
- consulting fee expenses
- deductions and expenses
- depreciable plant and articles
- depreciation expenses
- diminishing value method
- effective life
- expense apportionment
- Goods and Services Tax
- goods, equipment, plant and trading stock
- GST
- millennium bug
- office supplies
- prime cost method
- producing assessable income
- repairs and maintenance expenses
- revenue expenses
- self education expenses
- staff training expense
- trading stock
- trading stock on hand
- trading stock valuation
- Year 2000

Legislative references:

- ITAA 1997 8-1
- ITAA 1997 25-10(1)
- ITAA 1997 42-15(b)
- ITAA 1997 42-25
- ITAA 1997 42-125
- ITAA 1997 42-130
- ITAA 1997 46-25
- ITAA 1997 46-35
- ITAA 1997 46-45
- ITAA 1997 46-65
- ITAA 1997 46-75(1)
- ITAA 1997 46-75(2)

Case references:

- Sun Newspapers Ltd and Associated Newspapers Ltd v. FCT (1938) 61 CLR 337; 1 AITR 403

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