TAX TALKS

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Div 40 is about the deprecation of plant and equipment.

Div 40 ITAA 97

In 2017 the deductions coming through Div 40 were significantly curtailed but they are still better than nothing.

Div 40

Division 40 is about the depreciation of depreciating assets and other capital expenditure.

It provides standardised rules for claiming specific deductions for certain types of capital expenditure. Depending on the type of expenditure you can achieve this either by claiming an immediate deduction. Or by deducting it over a period of time.

Terminolgy

There are various terms used for all this. Div 40 doesn’t actually use the term depreciation as such. It talks about deductions.

The ATO refers to Div 40 as the uniform capital allowance provisions. Accordingly, a deduction under Div 40 is a capital allowance.

Concept

Section 40-10 ITAA97 outlines core concepts.

Core Concept # 1   Depreciating Assets

Depreciating assets are assets with a limited effective life that are reasonably expected to decline in value over the time they are used. Land and trading stock are not depreciating assets. Intangible assets are only depreciating assets if they are listed in s 40-30(2) (eg in-house software or intellectual property)

Core Concept # 2   Components

Whether a composite item is itself a depreciating asset, or whether its components are separate depreciating assets, is a question of fact and degree in the circumstances (see examples under s 40-30(4) ITAA97; and Draft TR2017/D)

Core Concept # 3 Effective Life

Broadly, the effective life of a depreciating asset is the period you can use it to produce income.

Core Concept # 4 Deemed Decline in Value

The decline in value is based on the cost and effective life of the depreciating asset, not its actual change in value.

Core Concept # 5 Economic Owner

Usually, the owner of a depreciating asset holds the asset and can therefore claim deductions for its decline in value. Sometimes, the economic owner will be different to the legal owner and the economic owner will be the holder.

Previously Used

You can no longer depreciate previously used plant and equipment in rental premises used for residential accommodation.

The changes apply from 1 July 2017 to previously used plant and equipment acquired at or after 7.30 pm on 9 May 2017 unless it was acquired under a contract entered into before this time. The changes also apply to plant and equipment acquired before 1 July 2017 but not used to earn income in either the current or previous year.

But if you purchase new plant and equipment, you can claim a deduction over the effective life of the asset.

The changes do not affect deductions that arise in the course of carrying on a business. The also don't affect or for corporate tax entities, superannuation plans other than self-managed superannuation funds, public unit trusts, managed investment trusts and unit trusts or partnerships whose members are the above listed entities.

Holder of asset

Identifying the holder of the asset can sometimes be difficult. Section 40-40 ITAA97 includes a table which assists in working out the holder of asset. The holder of the asset can claim a decline in value deduction on the asset.

Methods

In calculating the decline in value, a taxpayer can choose between the *prime cost method* or the *diminishing value method* for a particular asset. Once a taxpayer chooses a method for a particular asset, the taxpayer cannot change the method for that asset (s 40-65 ITAA97).

ss40-70, 40-72 and 40-75 ITAA97 list the relevant formulas.

Prime Cost

The prime cost method lives in s40-75 ITAA97. The formula is:

Cost of asset / Effective life

And if you only hold an asset for part of a year, then you pro rata the deprecation for that year. You mulitply the depreciation for the full year with the quota of days held (Days Held/ 365).

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Diminishing Value

The diminishing value method lives in s 40-70 ITAA 97. The formula for any depreciating assets held after 9 May 2006 is:

Base value x 200%/ Effective life

The concept of *base value* is defined in s 40-70(1). An asset starts to decline when its "start time" occurs. This is when the taxpayer first uses the asset, or has it installed ready for use, for any purpose (s40-60).

Effective Life

Under the capital allowance rules, you are allowed to either self-assess the effective life of an asset by making your own estimate of the number of years the asset can be used for taxable purpose (including wear and tear factors).

Or you can use the Commissioner's effective life rate as listed in the relevant taxation ruling for that year.

Cost of Depreciating Assets

Subdivision 40-C ITAA97 provides that the cost of a depreciating asset includes both expenses you incur to start holding the asset, and additional expenses that contribute to its present condition and location, for example improvements.

The cost of a depreciating asset consists of two elements – first and second element costs.

First elements costs are expenses to hold the asset s40-180 ITAA97. They are amounts paid that are directly connected with holding the asset.

Second elements costs are expenses after the taxpayer starts to hold the asset that bring the asset to its condition and location from time to time s 40-190 ITAA97. An example are capital improvement costs. They also include expenditure incurred that is reasonably attributable to a balancing adjustment event

The following table summarises the amounts that are included and excluded from the cost of depreciating asset:

Included in Cost

The cost of a depreciating asset generally consists of amounts a taxpayer has paid, or is taken to have paid, in relation to the asset (s 40-180 and s 40-190).

These amounts include non-cash benefits that a taxpayer has provided. s 40-185(1) ITAA97 lists some examples.

In certain circumstances, the cost will instead be a particular amount attributed under the cost rules rather than the amount actually paid. An example would be when a taxpayer becomes a holder under a luxury car lease.

Not Included in Cost

The cost of a depreciating asset does not include GST input credits and decreasing adjustments, amounts deductible outside Div40 and expenses not of a capital nature (s 40-220 ITAA97).

They also don't include amounts deductible for expenditure on mining, quarrying or prospecting information and amounts incurred before 1 July 2001 (or under a contract entered into before that date) on a depreciating asset that is not plant (s 40-210 ITAA97).

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The first element cost of a car is reduced to the car limit (s 40-230 ITAA97), except when modifications are made for the use of disabled individuals (s 40-230(2).

The first element of cost of a car is increased by a part of any discount that relates to the disposal of another depreciating asset for less than market value s 40-320 ITAA97. The car limit changes on a regular basis but is $57,581 for 2018/19.

Balancing Adjustments

The law relating to balancing adjustments under the UCA is outlined in Subdiv 40-D.

When you stop holding a depreciating asset, a balancing adjustment event happens (s40-295(1) ITAA97) and you may have to include an amount in your assessable income, or deduct an amount under a balancing adjustment. The adjustments reconciles the decline with actual change in value.

An amount is included in assessable income when the termination value (sales price) of a depreciating asset is more than its adjustable value (written down value) (s40-285(1)).

An amount is deducted from assessable income when the termination value of a depreciating asset is less than its adjustable value (written down value) (s 40-285(2)).

There is a reduction to the amount included in or deducted from assessable income in proportion to the extent of the private use of the depreciating asset (s 40-290).

To the extent that a balancing adjustment event happens in relation to the income producing portion of the depreciating asset, any capital gain or loss from a CGT event that also happens is regarded (s 118-24 ITAA97). This is because the gain or loss on the income-producing portion is recognised under the balancing adjustment rules in Div40.

Termination Value

The termination value of a depreciating asset is worked out using the table in s 40-300. It generally includes the amounts that a taxpayer received (or was taken to have received) in relation to the asset. This includes any money and non-cash benefits received by the taxpayer.

An amount received for two or more things will be apportioned between the termination value of the depreciating asset and those other things.

The termination value does not include expenses relating to balancing adjustments.

If you use a depreciating asset for a non-taxable purpose, reduce the balancing adjustment to reflect that non-taxable use. The reduced balancing adjustment amount is included in, or deducted from your assessable income under the UCA provisions.

Example # 1

Bob sells a computer. The termination vale of the computer is $600 and its cost is $1000. Bob used the computer 40% for private purposes. At the time of its sale, the computer adjustable value is $700. Bob can claim a deduction of $60 for the reduced balancing adjustment (60%, the taxable purpose proportion, of $700, less $600)

Special Termination Value for Cars

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You adjust the termination value of a car per s 40-325 where the car limit applies. And you increase it by any discount that relates to the disposal of another depreciating asset for less than market value.

Immediate Deductions

The UCA provision sometimes allow a taxpayer to claim an immediate deduction for capital expenditure, rather than depreciating it.

Subdiv 40-H

The UCA provisions in Subdiv 40-H provide an immediate deduction for certain capital expenditure on:

- exploration or prospecting
- rehabilitation of mine and quarry sites
- paying petroleum taxes
- environmental protection activities

Primary Production

In addition, the primary production rules outline some circumstances in which primary producers can claim immediate deductions under the UCA provisions, rather than depreciating the capital expenditure (eg capital costs incurred on certain landcare operations).

Minor Assets

And an immediate deduction for a depreciating asset is also available when the asset (s 40-80(2) ITAA97)

- Costs $300 nor less, and is
- Used predominantly for the purpose of producing assessable income that is not income from carrying on a business (ie employment related, investment or rental property), and is
- Not part of assets acquired in the same income year that costs more than $300, and is
- Not one of a number of substantially identical items acquired in the same income year that together costs more than $300.

As an administrative convenience, PS LA 2003/8 provides an administrative convenience. You can directly expense any expenditure of $100 or less (GST-included) incurred to acquire a tangible asset in the ordinary course of carrying on a business (where PS LA 2003/8 applies to the expenditure).

One example is office equipment costing $100 or less such as hand-held staplers, hole punches, manila folders, ring binders, calculators, tape dispensers, scissors and labelling machines). Another example is catering items in a cafe costing $100 or less such as cutlery, saucers, cups and table linens. And a third example is a tradesperson's small hand tools costing $100 or less such as pliers, screwdrivers and hammers.

The $100 threshold reflects the reality that expenditure covered by the rule is likely to be revenue in nature and that further inquiries into whether the expenditure is truly revenue or capital in nature is likely to involve substantial cost without materially changing the outcome.

Example # 2

Jan buys four matching chairs for the dining table in her rental property. Each chair costs $150. Jan cannot claim an immediate deduction for the cost of each individual chair because they are substantially identical and their cost exceeds $300.

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Example # 3

Paula, a primary school teacher, is buying a series of story books costing $65 each. The books come in labelled volumes of 1-10 but she buys one volume every month during the school year. Although Paula only receives five volumes before 30 Jun, she cannot claim an immediate deduction for any of these books because they form a set and the total cost is more than $300.

Low-Value Pools

Subdivision 40-E ITAA97 of the UCA regime provides that you can place low-cost depreciating assets, and assets depreciated to a low value into a low-value pool. You treat this pool as a single depreciating asset.

Pool Assets

Taxpayers, other than small business taxpayers who choose to use the simplified capital allowances regime, may choose to allocate to a low-value pool the following assets:

- all assets costing less than $1,000 (low cost assets – s 40-425(1) ITAA97)
- assets that have declined in value under the diminishing value method to less than $1000 (low -value assets – s 40 425(3)).

Method

Broadly, you work out the decline in value for assets in the low-value pool on a diminishing value basis as if all the pooled assets had an effective life of four years (37.5%).

The deprecation of low-cost assets added to the pool during the year is at half the pool rate (18.75%). The depreciation of low-value assets allocated to the pool during the year on the other hand is at the full pool rate (37.5%).

If you start to pool low-cost assets, you must do so for all such assets of that year. And you must also do that for future years.

You can also choose to add assets that have declined to less than $1,000 under the diminishing value method.

Section 40-440(1) ITAA97 details the method used to calculate the decline in value of the low-value pool. While s 40-440(2) details how to calculate the closing pool balance itself.

If you sell a pool asset during the year, you deduct the sale price from the closing pool balance.

But only to the extent it reaches zero (s 40-445(1) ITAA97). The amount in excess of zero becomes assessable income (s 40-445(2)).

MORE

Active Asset Test

Div 7A UPE

UPE in the Maximum Net Asset Value Test

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