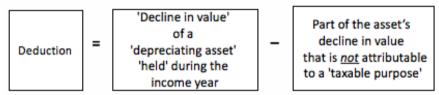
TOPIC 7: CAPITAL WRITE OFFS AND ALLOWANCES

Introduction

- Depreciating assets capital in nature no deduction allowed per <u>s8-1</u> (first neg limb)
- Capital expenditure is only deductible if it falls into a specific deduction provision
- We study two regimes that provide deductions for capital expenditure:
 - o 1) Capital allowance regime (Div 40 ITAA97): deduct cost of depreciating assets
 - o 2) Capital works regime (Div 43 ITAA97): deductions for construction expenditure

7.1 Capital allowance regime (Div 40 ITAA97)

- <u>s40-25(1)</u>: provides deductions for the 'decline in value' for an income year of 'depreciating assets' that it 'held' during the year
 - <u>s40-25(2)</u>: deduction reduced by the decline in value attributable to the entity's use of the asset (or installation ready for use) for a purpose other than a 'taxable purpose'



- Five steps to consider:
 - Must have a *depreciating asset* (s40-30)
 - Must have a *holder* of the depreciating asset (s40-40)
 - Must have a taxable purpose (s40-25(7))
 - o Calculate the *decline in value* for the income year (s40-70; s40-72; s40-75)
 - Calculate the tax consequences of any balancing adjustment events

i) Must have a 'Depreciating asset' (s40-30):

- <u>s40-30(1)</u>: An asset that has a *limited 'effective life'* and can **reasonably be expected to decline in value** over the time it is used
- (1) Excludes:
 - (a) Land;
 - (b) trading stock (already covered by s8-1);
 - (c) Intangible assets that are not mentioned in s40-30(2) (eg. goodwill)
 - o **'goodwill'**: the price paid to acquire a business over the value of tangible assets less liabilities
- **Eg.** Fridges in a supermarket; display cabinets in cake shop; computers in an office; tools for construction workers
- <u>\$40-30(2):</u> these intangible assets are depreciating assets if they are not trading stock: mining, quarrying or prospecting rights; items of intellectual property
- <u>s40-30(3)</u>: Improvements/fixtures on the land (removable or not) are treated as **separate assets** from the land
 - However, it is generally not possible to deduct amounts under Div 40 in relation to expenditure on items such as buildings – the Div does not apply to 'capital works' deductible under Div 43 (<u>s40-45(2)</u>)

• <u>S40-30(4)</u>: Whether a *composite item* is itself a *depreciating asset* or is a number of separate depreciating assets is a **question of fact and degree** (eg. car has many separate components, but is a depreciating asset for all combined)

ii) Must have a 'Holder' (s40-40): (p257 leg book)

- 'Holder' determined in accordance with table in <u>s40-40</u>
 - Generally, the holder is the 'legal owner' of the asset
 - Sometimes it is the 'economic owner' of the asset if has right to use (and expected to become legal owner
 - The 'holder' is the lessor and hiree of lease/hire license

iii) Must have a 'Taxable purpose' is (s40-25(7)):

- (a) for the purpose of producing AI,
- (b) purpose of exploration or prospecting, **(c)** purpose of mining site rehab; or **(d)** environmental protection activities

iv) Calculate the Decline in value:

- Start date: s40-60(1) Decline in value commences from the 'start time':
 - o (2) When the entity first uses the asset, or it is installed or ready to use for any purpose
- Two methods to calculate a decline in value:
 - o a. 'Prime cost method' (<u>s40-75</u>); or
 - b. 'Diminishing value method' (DVM)

Pre 9 May 2006: <u>s40-70</u>

Post 9 Mat 2006: s40-72

DATE IS CRUCIAL

- **s40-65:** entities can choose which method to use
- <u>s40-130</u>: Once a method to calculate the decline in value of an asset it cannot be changed
- Alternatively, special 'pooling rules' (s40-E) can apply to low cost/value assets: (<u>s40-425</u>)
 - Low cost assets (cost <\$1000)
 - Low value assets (opening adjustable value <\$1000)

a. Prime cost method:

Asset Cost
$$\times$$
 $\frac{Days\ Held}{365}$ \times $\frac{100\%}{Asset's\ Effective\ Life}$

- Days held: the number of days in the income year that the entity held the asset (ignoring any days it did not use it or have it installed ready for use)
- O Asset's cost:
 - Two elements (<u>s40-175; s40-185</u>):
 - 1) the amount paid to hold the asset (eg. cash paid to acquire the asset)
 - 2) the amount paid for each economic benefit that contributed to bringing the asset to its current condition/location (eg. cash paid to transport or modify an asset)
 - Certain amounts are excluded:
 - The cost of depreciating asset is reduced by the amount of any **input tax credits** available to the entity (**s27-80**)