

**LAWS6840 – Taxation of Business and Investment Income A**

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## Repairs, improvements and wasting assets

Important aspects to this topic:

- Basic operation of Div 40 (depreciating assets)
- Calculation of cost
- Calculation of decline in value
- Treatment of disposals of depreciating assets
- Distinction between repairs and improvements

### Repairs

#### Repairs are deductible

ITAA 1997 – Part 2-5 – Deductibility of particular amounts	
Division 25 – Some amounts you can deduct	
<b>25-10</b>	<p><b>Repairs</b></p> <p>(1) You can deduct expenditure you incur for repairs to <b>premises</b> (or part of premises) or a <b>depreciating asset</b> that you held or used solely for the <b>purpose</b> of producing assessable income.</p> <p><u>Property held or used partly for that purpose</u></p> <p>(2) If you held or used the property only partly for that purpose, you can deduct so much of the expenditure as is reasonable in the circumstances.</p> <p><u>No deduction for capital expenditure</u></p> <p>(3) You cannot deduct capital expenditure under this section.</p> <p><b>Note</b></p> <ul style="list-style-type: none"><li>• Note, refers to “held or used” not owned.</li><li>• The asset does not have to be “used” at the exact time of the repair expenditure (as a rule of thumb, if they both occur in the same income year that will likely be acceptable). However, if the expenditure is too premature / no business is being carried on yet, it may not be deductible (<i>Softwood Pulp</i> [1976]).</li></ul>

Elements:

- Expense **incurred**; for
- A **repair** (i.e. not capital expenditure / improvements); of
- **Premises** or a **depreciating asset**; to the extent
- Held or used for a **taxable purpose**

Arguably any expenses captured by s 25-10 would also be captured by s 8-1, but that does not mean a double deduction is possible (s 8-10).

**What is a repair?**

The term “repair” is not defined in the Acts, so takes its **ordinary meaning**:

- Making good a defect; a renewal of the part not of the entire (*Lurcott* [1911])
- Restoring an item to sound or unimpaired condition
- Renewal of worn-out / decayed parts
- Re-affixing what has become detached or loose
- Remedying or replacing; occasional and partial in nature (TR 97/23)

<p><b><i>Lurcott</i></b> <b>[1911] 1 KB 905</b></p> <p>Ordinary meaning of “repair”</p> <p>Repair of defective part vs replacement of the whole</p> <p>Replacing one wall of a house – held to be a mere repair</p>	<p><b>Facts</b></p> <ul style="list-style-type: none"> <li>▪ This case considered the ordinary meaning of the term “repair” in the context of knocking down and rebuilding the front wall of a house.</li> </ul> <p><b>Held</b></p> <ul style="list-style-type: none"> <li>▪ The Court distinguished between renewing one part of a whole, and renewing the entire whole:</li> </ul> <p><i>...the question of repair is in every case one of degree, and the test is whether the act to be done is one which in substance is the renewal or replacement of defective parts, or the renewal or replacement of substantially the whole.</i></p> <p><i>Repair is restoration by renewal or replacement of subsidiary parts of a whole. Renewal, as distinguished from repair, is reconstruction of the entirety, meaning by the entirety not necessarily the whole but substantially the whole subject-matter under discussion.</i></p> <ul style="list-style-type: none"> <li>▪ In this case, replacing the wall was a mere repair:</li> </ul> <p><i>When it has got its new wall it will not be a new house; it will be the old house put into repair in the sense that there has been renewed or replaced a worn out subordinate part of the whole.</i></p>
<p><b><i>BP Oil Refinery</i></b> <b>[1992] FCA 14</b></p> <p>Repairs vs improvements</p> <p>Work done to <u>prevent or anticipate defects in the future</u> is not itself a repair, unless perhaps done in conjunction with remedying other defects</p>	<p><b>Facts</b></p> <ul style="list-style-type: none"> <li>▪ BP ran an oil rig in the sea, in respect of which several depreciation issues arose.</li> <li>▪ One of the issues was how to treat expenditure for work carried out on the wooden piles supporting the refinery to prevent their deterioration by marine life.</li> <li>▪ The piles, made of wood, were encased in concrete. The casings did not and were not intended to have any effect on the damage previously done. Rather, the purpose was to prevent further damage.</li> <li>▪ The taxpayer asserted, and the Commissioner denied, that the expenditure was for “repairs” and therefore deductible.</li> </ul>

	<p><b>Held</b></p> <ul style="list-style-type: none"> <li>▪ Against the taxpayer – capital improvement, not a repair – not deductible.</li> <li>▪ Work will not be considered repair unless it includes some restoration of something lost or damaged, whether function or substance or some other quality. The work in this case did not achieve that, the physical substance of the casing and the capacity to resist further damage by marine organisms being improvements.</li> </ul>
<p><b>Wangaratta Woollen Mills [1969] HCA 39</b></p> <p>Modifications to a piece of plant / equipment</p> <p>May not constitute a separate piece of depreciating plant, and also may not constitute a repair</p>	<p><b>Facts</b></p> <ul style="list-style-type: none"> <li>▪ See facts above.</li> </ul> <p><b>Held</b></p> <ul style="list-style-type: none"> <li>▪ Modifications to a piece of plant / equipment may not constitute a separate piece of depreciating plant, and also may not constitute a repair: <p><i>The final item is the modifications to the Fulscope controller. This was an electrical device which enabled the temperature of the liquid in the vats to be raised at a set rate. The modification in question enabled the device to regulate cooling as well as heating. The modification consisted of the addition of several small pieces of electrical equipment to the controller which would have involved a considerable amount of workmanship.</i></p> <p><i>I am of opinion that the modifications cannot be regarded as a unit of property, nor can the collection of bits of wire, switches, lights, etc, be separately so regarded. The expenditure was on a modification to an existing unit of property, the Fulscope controller, not an addition.</i></p> <p><i>It is anomalous that if a separate cooling controller had been installed a deduction would have been allowed. A modification appears to fall between capital expenditure and repairs, and to attract the deductions of neither.</i></p> </li> <li>▪ In this case, you probably seek to re-cost the piece of plant that has been modified (to increase your depreciation deductions).</li> </ul>

<p><b>TR 97/23</b></p> <p>Deductions for repairs</p>	<p>15. <i>Repair for the most part is occasional and partial. It involves restoration of the efficiency or function of the property being repaired without changing its character and may include restoration to its former appearance, form, state or condition. A repair merely replaces a part of something or corrects something that is already there and has become worn out or dilapidated. Works can fairly be described as 'repairs' if they are done to make good damage or deterioration that has occurred by ordinary wear and tear, by accidental or deliberate damage or by the operation of natural causes (whether expected or unexpected) during the passage of time.</i></p> <p>...</p> <p>21. <i>What is a 'repair' for the purposes of s 25-10 is a question of fact and degree in each case having regard to the appearance, form, state and condition of the particular</i></p>
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property at the time the expenditure is incurred and to the nature and extent of the work done to the property.

Repairs of a capital nature

32. Expenditure for repairs to property is capital expenditure if any of the following subparagraphs applies:

(a) The guidelines for distinguishing between capital and revenue outgoings laid down by the courts for the purposes s 8-1 in such cases as *Sun Newspapers* [1938] and *Hallstroms* [1946] indicate that the expenditure is incurred in establishing, replacing or enlarging the profit-yielding (i.e. business) structure rather being a working or operating expense.

(b) The expenditure, rather than being for work done to restore the property by renewal or replacement of subsidiary parts of a whole, is for work that is a renewal in the sense of a **reconstruction of the entirety**.

(c) If property bought for use as a capital asset in the buyer's business is not in good order and suitable for use in the way intended, expenditure incurred in putting it in order suitable for use is part of the cost of its acquisition and is of a capital nature.

33. The cost of replacing things such as free-standing stoves, refrigerators and furniture in premises used for income purposes is capital expenditure and is not deductible under section 25-10. Note, however, that these items (if they are not permanent fixtures) are plant on which depreciation is allowable (TR IT 242).

No deduction for 'notional' repairs

35. If work done goes beyond 'repair' and the whole cost is capital expenditure, no amount is allowable as a deduction under s 25-10 for 'notional' repairs (i.e. an amount it is estimated that repair work would have cost the taxpayer if the property had in fact merely been repaired).

## Initial repairs

Initial repairs are not deductible under s 25-10 or s 8-1, and instead form part of the cost of the depreciating asset acquired (or the cost base, if it is a CGT asset).

The rationale for this rule is that the purchase price of the asset was likely reduced to account for the state of disrepair, and the initial repairs make up for that (i.e. capital outlay).

A key element is often whether the asset was in **working condition at the time of acquisition**. If not, any repairs are likely to be initial repairs on capital account.

Relevant cases:

<p><b><i>W Thomas &amp; Co</i></b> <b>[1965] HCA 54</b></p> <p>To “repair” is to restore an item to its previous condition without changing its character</p> <p>Initial repairs go the cost of acquisition – capital – not deductible</p> <p>Question of fact and degree</p>	<p><b>Facts</b></p> <ul style="list-style-type: none"> <li>▪ The taxpayer acquired a building to be used as a flour mill, and incurred expenditure repairing various items (e.g. roof and guttering, walls, painting, wooden floors).</li> <li>▪ It sought to deduct those costs.</li> </ul> <p><b>Held</b></p> <ul style="list-style-type: none"> <li>▪ Against the taxpayer – initial repairs – capital – not deductible.</li> <li>▪ The expenditure, although made for the purpose of repairs, was, nevertheless, expenditure of a capital nature, being for repairs <b>made for the purpose of putting the purchased building into a condition suitable for its use</b> by the taxpayer company.</li> <li>▪ A “repair” involves a restoration of a thing to a condition it formerly had without changing its character. <b>It is restoration of efficiency in function rather than exact repetition of form or material that is significant.</b></li> <li>▪ Whether or not work done upon a thing is aptly described as a repair of that thing is thus a question of fact and degree. But the answer to that question does not of itself decide whether the expenditure on the work is properly to be considered as an outgoing upon capital account or upon revenue account.</li> <li>▪ When a thing is bought for use as an income-producing capital asset, if it is not in good order and suitable for use in the way intended, the cost of putting it in order suitable for use is part of the cost of its acquisition, not a cost of its maintenance, and such expenditure, therefore, is not properly attributable to revenue account and is not deductible from assessable income of the purchaser.</li> <li>▪ The question arises – is it necessary for there to have been an express adjustment to the purchase price in light of the disrepair? Probably not.</li> </ul>
<p><b><i>Law Shipping Co</i></b> <b>[1923] 11 WLUK 60</b></p> <p>Expenses to get a newly acquired ship up to seaworthiness</p> <p>Initial repair – capital account</p>	<p><b>Facts</b></p> <ul style="list-style-type: none"> <li>▪ The taxpayer ran a shipping company, which purchased a steamship and despatched it on a voyage.</li> <li>▪ On the completion of the voyage it was put through a survey, and thereafter the company expended large sums on repairs which were found to be necessary.</li> <li>▪ The taxpayer claimed a deduction for the repairs.</li> </ul>

	<p><b>Held</b></p> <ul style="list-style-type: none"> <li>▪ Initial repair – capital account – not deductible.</li> <li>▪ Except for any portion of the repair expenses that could be attributed to repair needs arising during the taxpayer's ownership of the ship (i.e. as a result of that first journey), the expenditure fell to be regarded as capital expenditure, and therefore was not deductible.</li> </ul>
<p><b>Odeon Theatres [1973] Ch 288</b></p> <p>Repairs to cinema after purchase</p> <p>Not initial repairs – not on capital account</p> <p>Asset was in working condition upon acquisition</p>	<p><b>Facts</b></p> <ul style="list-style-type: none"> <li>▪ In 1945, the taxpayer purchased a cinema at Marble Arch, London. The cinema was in a worn-down state but fully operational.</li> <li>▪ Extensive repairs were performed over 10 years. The repairs had essentially been put off by the former owner, and now the taxpayer was taking them on.</li> </ul> <p><b>Held</b></p> <ul style="list-style-type: none"> <li>▪ In favour of the taxpayer – not initial repairs – revenue account – deductible.</li> <li>▪ Although the works improved on the initial condition, they were not 'initial repairs' on capital account. A key fact was that the cinema was in working condition when purchased.</li> <li>▪ In determining what was capital and what was revenue expenditure for income tax purposes, the courts followed the established principles of commercial accounting unless they conflicted with statute law. According to those principles the expenditure on the deferred repairs was rightly charged to revenue, and not capital, account. Such expenditure was laid out by the taxpayers wholly and exclusively for the purpose of their trade, and was therefore deductible.</li> </ul>

<p><b>TD 98/19</b></p> <p>Initial repairs incurred after acquisition may be included in cost base</p>	<ul style="list-style-type: none"> <li>▪ "Initial repairs" that are <b>not deductible</b> may form part of the cost base (4<sup>th</sup> element) of an asset on the basis that the amount required to be paid for the CGT asset would reflect its degraded value.</li> </ul> <p>3. <i>If initial repair expenditure is apportioned to allow a deduction under s 25-10 (deductibility of repairs) for a part of the expenditure that remedies deterioration of the asset (see paras 63 to 66 of TR 97/23), the cost base of the CGT asset may only include the expenditure to the extent that it is not deductible under s 25-10.</i></p> <p>4. <i>The expression 'initial repair' is used in the same sense that it is used in para 5 of TR 97/23. A repair is not an 'initial repair' simply because it is the first repair made to an asset after it is acquired. It is an 'initial repair' only if repair is necessary when the asset is acquired because the asset has defects, damage or deterioration or is not in good order and suitable for use in the way intended. To be an 'initial repair' the work done to the asset must be a 'repair' in the ordinary meaning of the word (that is, the remedying or making good of defects in, damage to, or deterioration of, the asset to restore its efficiency of function without changing its character); it must not be an improvement, addition or alteration nor be a renewal.</i></p>
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	<p><b>restoration or reconstruction of the entirety of the asset</b> (although a minor or incidental degree of improvement may still be a repair).</p> <ul style="list-style-type: none"> <li>▪ If the property is used to produce income, ordinarily repair costs will be deductible.</li> </ul>
<p><b>TR 97/23</b> Deductions for repairs</p>	<p>4. <i>In this Ruling, the expression 'initial repair' refers to a repair by a taxpayer that remedies some defect in property or makes good damage to, or deterioration of, property being a defect, damage or deterioration:</i></p> <p>(a) <i>existing when the property was acquired from another person (whether by purchase, lease or licence); and</i></p> <p>(b) <i>not arising from the operations of the taxpayer who incurs the repair expenditure [i.e. apportionment is required to the extent that taxpayer use contributed to the need for the initial repair].</i></p> <p>5. <i>A repair is not an 'initial repair' simply because it is the first repair made after property is acquired. It is an 'initial repair' if repair is due when the property is acquired in the sense that the property has defects, damage or deterioration or is not in good order and suitable for use in the way intended.</i></p> <p>...</p> <p>59. <i>Expenditure incurred on an initial repair after property is acquired, if the expenditure is incurred in remedying defects, damage or deterioration in existence at the date of acquisition, is capital expenditure and is not, therefore, deductible under s 25-10... The cost of effecting an initial repair is still not deductible even if some income happens to be earned after acquisition but before the repair expenditure is incurred.</i></p> <p>...</p> <p>61. <i>It is immaterial whether at the time of acquisition the taxpayer was aware of the condition of the property, including its need for repair. It is also immaterial whether the purchase price (or lease rentals) reflected the need for repairs... Initial repair expenditure relates to the establishment of the profit-yielding structure. It is capital expenditure and is not deductible under s 25-10.</i></p>

## Repairs vs capital improvements

Again this is another form of the revenue vs capital analysis.

The question is whether the work performed gives rise to a **new asset** in and of itself, or the work was merely done to a **component of an existing asset** (*W Thomas & Co* [1965]).

Although a repair does improve the property, a **substantial improvement** will not be a repair.

<p><b>Case V102 (1988) 19 ATR 3647</b></p> <p>Mixed repairs / capital improvements</p> <p>If it is possible to separate the repairs from the improvements, the taxpayer can do so in order to deduct the repair portion</p>	<p><b>Facts</b></p> <ul style="list-style-type: none"><li>▪ The taxpayer owned a building constructed in the 1930s which was let on commercial tenancies.</li><li>▪ In 1981, following an inspection by the Sydney City Council and the Board of Fire Commissioners, the taxpayer was required to modify aspects of the fire control system.</li><li>▪ A fire hose-reel system was installed, comprising pipework, hose-reels and a pump, and a new lighting system with independent circuitry was also installed.</li><li>▪ The taxpayer claimed deductions for the expenditure on the basis that the work constituted repairs.</li></ul> <p><b>Held</b></p> <ul style="list-style-type: none"><li>▪ Mostly in favour of the taxpayer – all works deductible except for installation of a new pump.</li><li>▪ With the exception of the installation of the pump, the works done replaced components of the existing system. Replacement was required because the equipment originally installed had come to be accepted as no longer adequate to meet standards. There was a restoration of efficiency in function, so that the works constituted repairs.</li><li>▪ The pump was required because, with the passage of time, independently of any deterioration in the capacity of the installed system, a change in mains pressure made it necessary to introduce a new element not previously required. The installation of the pump was a capital outlay and did not constitute a repair.</li><li>▪ Depreciation should be allowed on the cost of the pump.</li></ul>
<p><b>Western Suburbs Cinemas [1952] HCA 28</b></p> <p>Replacement of entire ceiling with different material – not a repair – capital improvement</p> <p>You cannot deduct ‘notional’ repairs</p>	<p><b>Facts</b></p> <ul style="list-style-type: none"><li>▪ The taxpayer ran a cinema business, and had to undertake work on the ceiling of one of the cinemas.</li><li>▪ The existing ceiling was in a bad state of repair, and it was found that the cost was not warranted as the work would be unsatisfactory in the way of repairs, so a new fibro ceiling was installed (i.e. different material).</li><li>▪ The taxpayer sought to deduct the amount it <u>would have</u> cost if they had instead done the repairs (rather than the full replacement).</li></ul> <p><b>Held</b></p> <ul style="list-style-type: none"><li>▪ Against the taxpayer – the work was a capital improvement – not deductible.</li></ul>

	<ul style="list-style-type: none"> <li>▪ You cannot deduct an amount for ‘notional repairs’ that never in fact occurred:</li> </ul> <p><i>Where an expenditure incurred in consequence of a state of disrepair is of a capital nature, it is not permissible to treat part of that expenditure as an allowable deduction on the ground that the state of disrepair could have been dealt with by incurring non-capital expenditure equal to that part, or on the ground that some items which entered into the expenditure incurred would have entered into a non-capital expenditure by means of which the state of disrepair could have been dealt with.</i></p>
<p><b>Rhodesia Railways</b> <b>[1933] AC 368</b></p> <p>Repair of worn railway track – not a capital improvement</p> <p>Despite using a different material for some of the work – no additional function was derived</p>	<p><b>Facts</b></p> <ul style="list-style-type: none"> <li>▪ The taxpayer ran a railway company.</li> <li>▪ They sought to deduct expenses incurred in renewing 74 miles of railway track. The work, which was part of a general scheme of renewal, included the supply of new rails, sleepers, and fastenings, where necessary.</li> <li>▪ Steel sleepers were used in place of wooden sleepers for about half the line renewed. The renewal brought the worn track back to normal condition.</li> <li>▪ As renewed, it was not capable of giving more service than the original line.</li> </ul> <p><b>Held</b></p> <ul style="list-style-type: none"> <li>▪ In favour of the taxpayer – revenue account – deductible.</li> <li>▪ The words “repairs” and “renewal” are not expressive of a clear contrast. The fact that the wear of the rails and sleepers of a railway line although continuous is not made good annually does not render the work of renewal, when it comes to be effected, necessarily a capital charge.</li> <li>▪ Expenditure may be a permissible deduction in assessing to income tax, although the benefit derived from it extends beyond the year of assessment.</li> </ul>
<p><b>Lindsay (No 2)</b> <b>[1941] Ch 119</b></p> <p>Work to replace flooring / drainage systems in rental cottages</p> <p>Capital improvement – not a repair</p>	<p><b>Facts</b></p> <ul style="list-style-type: none"> <li>▪ The taxpayer, an owner of a settled estate, was required by a local authority to update a number of cottages on the estate (occupied by servants or labourers) and to have their drains connected with a main sewer.</li> <li>▪ The work required was done, and a considerable part of it consisted of items, which taken singly and not as part of a comprehensive scheme, were repairs.</li> </ul> <p><b>Held</b></p> <ul style="list-style-type: none"> <li>▪ Against the taxpayer – capital improvements – not repairs.</li> <li>▪ The whole of the work which had been done could properly be said to be an “improvement” of the cottages, and therefore be on capital account.</li> </ul>

<p><b>Wates v Rowland</b>  <b>[1952] 2 QB 12</b></p> <p>Replacement and improvement of house floor</p> <p>Capital improvement – not a repair</p>	<p><b>Facts</b></p> <ul style="list-style-type: none"> <li>▪ The taxpayer was the landlord of a rental house, the floor of which had become rotten due to the water level rising.</li> <li>▪ The taxpayer laid a further layer of concrete on the original concrete foundation raising the surface by nine inches. On that surface he laid a tiled floor (i.e. a new material).</li> </ul> <p><b>Held</b></p> <ul style="list-style-type: none"> <li>▪ Capital improvement – not a repair.</li> <li>▪ The expenditure on the addition of nine inches of concrete to the substratum of the house was prima facie expenditure on an “improvement”, since the house was a better house than it had ever been before.</li> <li>▪ Up to a point the work done was work of repair. The replacement of the floor would come within the description “repairs”. The landlord had, however, done more than provide a new floor. He had made a structural alteration and an improvement consisting of the laying of the additional concrete bed over the existing concrete.</li> </ul>
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<p><b>TR 97/23</b></p> <p>Deductions for repairs</p>	<p><u>Repair is distinct from improvement</u></p> <p>44. <i>In the case of a 'repair', broadly speaking, the work restores the efficiency of function of the property without changing its character. An 'improvement', on the other hand, provides a greater efficiency of function in the property – usually in some existing function. It involves bringing a thing or structure into a more valuable or desirable form, state or condition than a mere repair would do. Some factors that point to work done to property being an improvement include whether the work will extend the property's income producing ability, significantly enhance its saleability or market value or extend the property's expected life.</i></p> <p><u>Use of different materials</u></p> <p>48. <i>If expenditure is incurred in replacing or renewing a part of property with a material of a different type from the original, the work done may either repair the property, or be an improvement to it. The use of different materials is not in itself determinative of the issue.</i></p> <p>49. <i>Whether the use of a more modern material to replace the original material qualifies as a repair is a question determined on the facts of each case. It is restoration of a thing's efficiency of function (without changing its character) rather than exact repetition of form or material that is significant.</i></p> <p><u>Technological advances or enhancements</u></p> <p>53. <i>As a general proposition, the greater the degree of technological advancement involved in work done to property, the more it is likely the work goes beyond a 'repair'.</i></p> <p><u>Repairs done at the same time as improvements</u></p> <p>55. <i>The character of a repair does not necessarily change because it is carried out at the same time as an improvement.</i></p>
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When does a repair become an improvement? Relevant considerations:

- The use of a **different material** to the original (*Rhodesia Railways* [1925]; *Lindsay (No 2)* [1941]; *Wates v Rowland* [1952]; *Western Suburbs Cinemas* [1952])
- Repair **increases the value** of the asset
- Repair **reduces likelihood of future repairs** (*Western Suburbs Cinemas* [1952]; *BP Oil Refinery* [1992])
- Repair **expands the capital structure**

**Replacement of part vs replacement of whole**

There is a distinction between repairs that constitute (*Lindsay* [1961]):

- Replacement of a defective part (may be deductible as a repair)
- Replacement of the entire thing (likely to be on capital account)

<p><b><i>Lindsay</i></b> <b>[1961] HCA 93</b></p> <p>Repair vs replacement of a capital asset</p>	<p><b>Facts</b></p> <ul style="list-style-type: none"> <li>▪ The taxpayer ran a ship repair business, and had two 'slipways' on the premises (allowing ships to be hauled up onto land, and then raised, so they could be worked on).</li> <li>▪ Owing to deterioration certain work had to be done on one of the slipways. As it was impossible to secure timber of the same size and variety to replace the deteriorated timber, concrete was used instead. Various other changes were also made.</li> <li>▪ The result was a slipway thirty to forty feet longer than the old one, but otherwise of the same dimensions and capacity, possessing no practical advantages, and in some respects slightly less advantageous. No greater efficiency in operation was obtained.</li> </ul> <p><b>Held</b></p> <ul style="list-style-type: none"> <li>▪ Against the taxpayer – replacement of a capital asset, not a repair – not deductible.</li> <li>▪ For the purpose of determining whether the work in question was a repair, the slipway should be regarded as an entirety (as opposed to being merely a component of a larger entirety, being both slipways and the other plant).</li> <li>▪ Therefore, the work constituted a replacement of an entirety, rather than a mere repair.</li> </ul>
<p><b><i>Tully Coop Sugar</i></b> <b>[1983] FCA 163</b></p> <p>How do you identify the separate assets within a larger system?</p>	<p><b>Facts</b></p> <ul style="list-style-type: none"> <li>▪ The taxpayer operated a sugar mill.</li> <li>▪ It spent c. \$3m on improvements to its machinery at various stages of the milling process, which it claimed as depreciating assets.</li> <li>▪ The machinery fell into five categories:             <ul style="list-style-type: none"> <li>○ A pumping station</li> <li>○ Two crushing mills</li> <li>○ A mud filter station</li> <li>○ Two juice heaters</li> <li>○ An effert vessel</li> </ul> </li> </ul> <p><b>Held</b></p> <ul style="list-style-type: none"> <li>▪ Each item was an individual depreciating asset.</li> <li>▪ On delineating the separate assets within a larger process the Court commented:</li> </ul>

	<p><i>There is a unit of property if it is capable of independent existence, not necessarily self-contained nor necessarily separately used, but capable either of separate function or of function in conjunction with different parts, or in a different context, from its current user.</i></p> <p><i>Ultimately the test of what is a unit of property depends on the facts of the particular case. However, a test of fairly general application would be that it is the function or purpose of the particular item to which one looks to determine if it constitutes a unit of property.</i></p>
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<p><b>TR 2024/1</b></p> <p>Composite items</p> <p>Identifying the relevant depreciating asset</p>	<p><u>Introduction</u></p> <p>...</p> <p>3. <i>Where an asset consists of a number of components, it is necessary to determine whether that larger asset is itself a depreciating asset, or whether one or more of its components are separate depreciating assets. Identifying the relevant depreciating asset is important for working out its effective life and therefore the rate at which deductions can be claimed. A depreciating asset that is the composite item as a whole may have an effective life that is different to the effective life of any individual component or components. This enquiry may also be relevant when testing an asset's eligibility for certain immediate tax write-offs and concessions.</i></p> <p><u>Composite items</u></p> <p>6. <i>A 'composite item' is an item that is made up of a number of components that are each capable of separate existence. Subsection 40-30(4) directs an objective consideration of whether a particular composite item is itself a depreciating asset, or whether one or more of its components are separate depreciating assets – it is a question of fact and degree to be determined in the circumstances of the particular case.</i></p> <p><u>Guiding principles</u></p> <p>7. <i>...No one principle is determinative...</i></p> <p>8. <i>For a component of a composite item to be a depreciating asset, it is necessary that the component is capable of being separately identified and recognised as having commercial and economic value.</i></p> <p>9. <i>Purpose or 'functionality' is generally a useful guide to the identification of an item (Tully [1983]). Consider whether:</i></p> <ul style="list-style-type: none"> <li>○ <i>The depreciating asset will ordinarily be an item that performs a separate identifiable function, having regard to the purpose it serves in its business context</i></li> <li>○ <i>An item may be identified as having a discrete function, and therefore as a depreciating asset, without necessarily being self-contained or used on a standalone basis</i></li> <li>○ <i>The greater the degree of physical or functional integration of an item with other component parts, the more likely the depreciating asset will be the composite item</i></li> </ul>
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	<ul style="list-style-type: none"> <li>○ When the <b>effect of attaching</b> an item to another item (which itself has its own independent function) varies the function or operational performance of that other item, the attachment is more likely to be a separate depreciating asset</li> <li>○ When various components are purchased (whether via one or multiple transactions) to <b>function together as a system</b> and are <b>necessarily connected in their operation</b>, the depreciating asset is usually the system (the composite item)</li> </ul> <p>...</p> <p>14. The fact that an item cannot operate on its own and has no commercial utility unless linked or connected to another item or items, does not preclude it from being a separate depreciating asset.</p> <p>Where such items are designed to be used in a range of settings or in conjunction with a wide range of equipment or systems and are not acquired with other items as part of a system, this may indicate they are separate depreciating assets.</p> <p>15. An absence of a fixed physical connection between separate components of a composite item tends to indicate that each separate component is a depreciating asset.</p> <p>16. Where an element of a system is purchased or installed at a different time to the system (irrespective of its intended operation within a system) and has a separate identifiable function, that element may be a separate depreciating asset.</p> <p><u>Modifications</u></p> <p>17. A modification or alteration to an existing depreciating asset can itself be a separate depreciating asset. Such modifications can be of varying degrees.</p> <p>18. Where:</p> <ul style="list-style-type: none"> <li>○ An addition or attachment substantially alters a depreciating asset (the original depreciating asset)</li> <li>○ The original depreciating asset continues to perform its function</li> <li>○ The addition or attachment serves its own function</li> </ul> <p>the addition or attachment is likely to be a separate depreciating asset from the original depreciating asset.</p> <p>19. A modification which restructures or adds new components to an existing depreciating asset will result in the asset being merged into a new depreciating asset where the new depreciating asset has a different purpose or performs a different function from the original depreciating asset (s 40-125).</p> <p>20. By contrast, restorations and minor alterations that do not change the overall function of the existing depreciating asset will not be considered separate depreciating assets. Where expenditure on restoring a depreciating asset to its original condition constitutes a repair, no separate depreciating asset is created and the cost is unchanged for the purposes of</p>
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	<p><i>calculating the existing depreciating asset's decline in value deductions (s 40-215).</i></p> <p>21. <i>Work undertaken that goes beyond what is required to restore the asset to its original state may constitute a capital improvement. Capital improvements will not necessarily create a new depreciating asset.</i></p> <p>22. <i>Modifications to certain components of an existing depreciating asset to allow it to perform additional tasks or improve its efficiency will not necessarily be considered a separate depreciating asset.</i></p>
<p><b>TR 97/23</b></p> <p>Deductions for repairs</p>	<p><u>Repair is distinct from renewal or reconstruction</u></p> <p>36. <i>Repair is restoration by renewal or replacement of subsidiary parts of a whole. Renewal or reconstruction, as distinguished from repair, is restoration of the entirety.</i></p> <p><u>What is an 'entirety'?</u></p> <p>37. <i>The term 'entirety' is used by the courts in repair cases to refer to something 'separately identifiable as a principal item of capital equipment', 'a physical thing which satisfies a particular notion' and 'not necessarily the whole but substantially the whole of the [property] under discussion' (Lindsay [1960]).</i></p> <p>38. <i>Property is more likely to be an entirety if:</i></p> <ul style="list-style-type: none"> <li>○ <i>The property is separately identifiable as a principal item of capital equipment; or</i></li> <li>○ <i>The thing or structure is an integral part, but only a part, of entire premises and is capable of providing a useful function without regard to any other part of the premises; or</i></li> <li>○ <i>The thing or structure is a separate and distinct item of plant in itself from the thing or structure which it serves; or</i></li> <li>○ <i>The thing or structure is a 'unit of property' as that expression is used in the depreciation deduction provisions of the income tax law.</i></li> </ul> <p>39. <i>Property is more likely to be a subsidiary part rather than an entirety if:</i></p> <ul style="list-style-type: none"> <li>○ <i>It is an integral part of some larger item of plant; or</i></li> <li>○ <i>The property is physically, commercially and functionally an inseparable part of something else.</i></li> </ul>