Guide to depreciating assets 2020

To help you complete your tax return for 1 July 2019 – 30 June 2020

Covers deductions you can claim for depreciating assets and other capital expenditure

For more information go to **ato.gov.au**

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ABOUT THIS GUIDE

As a general rule, you can claim deductions for expenses you incurred in gaining or producing your income (for example, in carrying on a business) but some expenditure, such as the cost of acquiring capital assets, is generally not deductible. However, you may be able to claim a deduction for the decline in value of the cost of capital assets used in gaining assessable income.

Guide to depreciating assets 2020 explains:

- how to work out the decline in value of your depreciating assets
- what happens when you dispose of or stop using a depreciating asset, and
- the deductions you may be able to claim under uniform capital allowances (UCA) for capital expenditure other than on depreciating assets.

In this guide, when the words 'ignoring any GST impact' are used it should be noted that if you are not entitled to claim an input tax credit for GST for a depreciating asset that you hold, then the cost of the depreciating asset includes any GST paid.

Who should use this guide?

Use this guide if you bought capital assets to use in gaining or producing your assessable income and you would like to claim a deduction for the assets' decline in value. Also use this guide if you incurred other capital expenditure and want to know whether you can claim a deduction for the expenditure.

Small business entities

Small business entities may choose to use simplified depreciation rules. For more information see **Small business entities** on page 36.

Publications and services

To find out how to get a publication referred to in this guide and for information about our other services, see the inside back cover.

Unfamiliar terms

Unfamiliar terms are shown in bold when first used in this guide. For an explanation of these unfamiliar terms, see **Definitions** on page 40.

ABBREVIATIONS USED IN THIS PUBLICATION

ACT	Australian Capital Territory
CGT	capital gains tax
Commissioner	Commissioner of Taxation
EPA	environmental protection activities
forex	foreign exchange
GST	goods and services tax
LCA	low-cost asset
LVA	low-value asset
OAV	opening adjustable value
TOFA	Taxation of financial arrangements
TR	Taxation Ruling
TV	termination value
UCA	uniform capital allowance

DEDUCTIONS FOR THE COST OF DEPRECIATING ASSETS

Under income tax law, you are allowed to claim certain deductions for expenditure incurred in gaining or producing assessable income, for example, in carrying on a business. Some expenditure, such as the cost of acquiring capital assets, is generally not deductible. Generally, the value of a capital asset that provides a benefit over a number of years declines over its **effective life**. Because of this, the cost of capital assets used in gaining assessable income can be written off over a period of time as tax deductions.

Before 1 July 2001, the cost of plant (for example, cars and machinery) and software was written off as depreciation deductions.

Since 1 July 2001, UCA apply to most depreciating assets, including plant. Under UCA, deductions for the cost of a **depreciating asset** are based on the **decline in value** of the asset.

Simplifying tax obligations for business

The practice statement *Law Administration Practice Statement PS LA 2003/8 – Practical approaches to low-cost business expenses,* provides guidance on two straightforward methods that you can use if you are carrying on a business to help determine whether you treat expenditure incurred in acquiring certain low-cost tangible assets as revenue expenditure or capital expenditure.

Subject to certain qualifications, the two methods cover expenditure below a threshold and the use of statistical sampling to estimate total revenue expenditure on low-cost tangible assets. The threshold rule allows an immediate deduction for qualifying low-cost tangible assets costing $100 or less, including any GST. If you have a low-value pool (see **Low-value pools** on page 22), the sampling rule allows you to use statistical sampling to determine the proportion of the total purchases on qualifying low-cost tangible assets that is revenue expenditure.

We will accept a deduction for expenditure incurred on qualifying low-cost tangible assets calculated in accordance with this practice statement.

UNIFORM CAPITAL ALLOWANCES

UCA provide a set of general rules that apply across a variety of depreciating assets and certain other capital expenditure. UCA do this by consolidating a range of former capital allowance regimes. UCA replace provisions relating to:

- plant
- software
- mining and quarrying
- intellectual property
- forestry roads and timber mill buildings, and
- spectrum licences.

UCA maintain the pre-1 July 2001 treatment of some depreciating assets and capital expenditure such as certain primary production depreciating assets and capital expenditure.

UCA introduced deductions for some types of capital expenditure such as certain business and project-related costs; see **Capital expenditure deductible under UCA** on page 30.

You use these rules to work out deductions for the cost of your depreciating assets, including those acquired before 1 July 2001. You can generally deduct an amount for the decline in value of a depreciating asset you held to the extent that you used it for a **taxable purpose**.

However, an eligible small business entity may choose to work out deductions for their depreciating assets using the simplified depreciation rules; see **Small business entities** on page 36.

Steps to work out your deduction

Under UCA, there are a number of steps to work out your deduction for the decline in value of a depreciating asset.

- Is your asset a depreciating asset covered by UCA? See **What is a depreciating asset?** below.
- Do you hold the depreciating asset? See **Who can claim deductions for the decline in value of a depreciating asset?** on the next page.
- Has the depreciating asset started to decline in value? See **When does a depreciating asset start to decline in value?** on page 5.
- What method will you use to work out decline in value? See **Methods of working out decline in value** on page 6.
- What is the effective life of the depreciating asset? See **Effective life of depreciating assets** on page 12.
- What is the cost of your depreciating asset? See **The cost of a depreciating asset** on page 14.
- Must you reduce your deduction for any use for a non-taxable purpose? See **Decline in value of a depreciating asset used for a non-taxable purpose** on page 8.

Some of these steps do not apply:

- if you choose to allocate an asset to a pool
- if you can claim an immediate deduction for the asset
- to certain primary production assets
- to some assets used in rural businesses.

See **Working out decline in value** on page 5.

WHAT IS A DEPRECIATING ASSET?

A depreciating asset is an asset that has a limited effective life and can reasonably be expected to decline in value over the time it is used. Depreciating assets include such items as computers, electric tools, furniture and motor vehicles.

Land and items of trading stock are specifically excluded from the definition of depreciating asset.

Most intangible assets are also excluded from the definition of depreciating asset. Only the following intangible assets, if they are not trading stock, are specifically included as depreciating assets:

- in-house software; see **In-house software** on page 25
- certain items of intellectual property (patents, registered designs, copyrights and licences of these)
- mining, quarrying or prospecting rights and information
- certain indefeasible rights to use a telecommunications cable system
- certain telecommunications site access rights
- spectrum licences, and
- datacasting transmitter licences.

Improvements to land or fixtures on land (for example, windmills and fences) may be depreciating assets and are treated as separate from the land, regardless of whether they can be removed or not.

In most cases, it will be clear whether or not something is a depreciating asset. If you are not sure, contact us or your recognised tax adviser.

Second-hand depreciating assets in residential rental properties

From 1 July 2017, you cannot claim a deduction for the decline in value of certain second-hand depreciating assets in your residential rental property unless you are using the property in carrying on a business, including the business of letting rental properties, or you are an excluded entity.

These changes generally apply to depreciating assets:

- for which you entered into a contract to acquire, or which you otherwise acquired, at or after 7.30 pm on 9 May 2017, or
- which you used, or had installed ready for use, for any private purpose in 2016–17 or earlier, and for which you were not entitled to a deduction for a decline in value in 2016–17.

Residential rental property is residential premises you use to provide residential accommodation for the purpose of producing assessable income.

For more information about the limit on the deductions for decline in value of second-hand depreciating assets in your residential rental property, including on how the new rules apply to the assets allocated to low-value pools, see *Rental properties 2020* (NAT 1729).

Depreciating assets excluded from UCA

Deductions for the decline in value of some depreciating assets are not worked out under UCA. These depreciating assets are:

- depreciating assets that are capital works, for example, buildings and structural improvements for which deductions
  - are available under the separate provisions for capital works
  - would be available if the expenditure had been incurred, or the capital works had been started, before a particular date
  - would be available if the capital works were used in a deductible way in the income year
- cars, where you use the cents per kilometre method for calculating car expenses; this method takes the decline in value into account in its calculations
- indefeasible rights to use an international telecommunications submarine cable system, if the expenditure was incurred or the system was used for telecommunications purposes at or before 11.45am AEST on 21 September 1999
- indefeasible rights to use a domestic telecommunications cable system or telecommunications site access rights if the expenditure was incurred before 12 May 2004; special rules apply to deem certain of those rights to be acquired before that date, and to exclude certain expenditure incurred on or after that date that actually relates to an earlier right

- work-related items (such as laptop computers, personal digital assistants, computer software, protective clothing, briefcases and tools of trade), ordinarily eligible for a depreciation deduction under UCA, will not be eligible if:
  - the item was provided to you by your employer, or some or all of the cost of the item was paid for or reimbursed by your employer, and
  - the provision, payment or reimbursement was exempt from fringe benefits tax
- depreciating assets for which deductions were available under the specific film provisions.

WHO CAN CLAIM DEDUCTIONS FOR THE DECLINE IN VALUE OF A DEPRECIATING ASSET?

Only the **holder** of a depreciating asset can claim a deduction for its decline in value.

In most cases, the legal owner of a depreciating asset will be its holder.

There may be more than one holder of a depreciating asset, for example, joint legal owners of a depreciating asset are all holders of that asset. Each person's interest in the asset is treated as a depreciating asset. Each person works out their deduction for decline in value based on their interest in the asset (for example, based on the cost of the interest to them, not the cost of the asset itself) and according to their use of the asset.

In certain circumstances, the holder is not the legal owner. Some of these cases are discussed below.

If you are not sure whether you are the holder of a depreciating asset, contact us or your recognised tax adviser.

Leased luxury cars

A leased car, either new or second-hand, is generally a luxury car if its cost exceeds the **car limit** that applies for the financial year in which the lease is granted. The car limit for 2019–20 is $57,581; see **Car limit** on page 16.

For income tax purposes, a luxury car lease (other than a genuine short-term hire arrangement) is treated as a notional sale and loan transaction.

The **first element of cost** of the car to the lessee and the amount lent by the lessor to the lessee to buy the car is taken to be the car's market value at the start time of the lease. For further information on the first element of cost see **The cost of a depreciating asset** on page 14.

The actual lease payments made by the lessee are divided into notional principal and finance charge components. That part of the finance charge component applicable to the particular period may be deductible to the lessee.

The lessee is generally treated as the holder of the luxury car and is entitled to claim a deduction for the decline in value of the car. For the purpose of calculating the deduction, the first element of cost of the car is limited to the car limit for the year in which the lease is granted. For more information, go to **ato.gov.au** and search for 'Yearly car limit'.

Any deduction must be reduced to reflect any use of the car other than for a taxable purpose, such as private use. See **Decline in value of a depreciating asset used for a non-taxable purpose** on page 8.

If the lessee does not actually acquire the car from the lessor when the lease terminates or ends, the lessee is treated as if they sold the car to the lessor. The lessee will need to work out any assessable or deductible **balancing adjustment amount**; see **What happens if you no longer hold or use a depreciating asset?** on page 17.

Depreciating assets subject to hire purchase agreements

For income tax purposes, certain hire purchase and instalment sale agreements entered into after 27 February 1998 are treated as a notional sale of goods by the financier (or hire purchase company) to the hirer, financed by a notional loan from the financier to the hirer. The hirer is in these circumstances treated as the notional buyer and owner under the arrangement. The financier is treated as the notional seller.

Generally, the cost or value of the goods stated in the hire purchase agreement or the arm's length value is taken to be the cost of the goods to the hirer and the amount lent by the financier to the hirer to buy the goods.

The hire purchase payments made by the hirer are separated into notional loan principal and notional interest under a formula set out in Division 240 of the *Income Tax Assessment Act 1997*. The notional interest may be deductible to the hirer to the extent that the asset is used to produce assessable income.

Under UCA, if the goods are depreciating assets, the hirer is regarded as the holder provided it is reasonably likely that they will actually acquire the asset.

If these conditions are met, the hirer is able to claim a deduction for decline in value to the extent that the assets are used for a taxable purpose, such as for producing assessable income.

If the hirer actually acquires the goods under the agreement, the hirer continues to be treated as the holder. Actual transfer of legal title to the goods from the financier to the hirer is not treated as a disposal or acquisition.

On the other hand, if the hirer does not actually acquire the goods under the arrangement, the goods are treated as being sold back to the financier at their market value at that time. The hirer will need to work out any assessable or deductible balancing adjustment amount; see **What happens if you no longer hold or use a depreciating asset?** on page 17.

The notional loan amount under a hire purchase agreement is treated as a limited recourse debt; see **Limited recourse debt arrangements** on page 22.

Leased depreciating assets fixed to land

If you are the lessee of a depreciating asset and it is ffixed to your land, under property law you become the legal owner of the asset. As the legal owner you are taken to hold the asset. However, an asset may have more than one holder. Despite the fact that the leased asset is fixed to your land, if the lessor of the asset (often a bank or finance company) has a right to recover it, then they too are taken to hold the asset as long as they have that right to recover it. You and the lessor, each being a holder of the depreciating asset, would calculate the decline in value of the asset based on the cost that each of you incur.

EXAMPLE: Holder of leased asset fixed to land

Jo owns a parcel of land. A finance company leases some machinery to Jo who pays the cost of fixing it to her land. Under the lease agreement, the finance company has a right to recover the machinery if Jo defaults on her lease payments.

The finance company holds the machinery as it has a right to remove the machinery from the land. The finance company is entitled to deductions for the decline in value of the machinery, based on the cost of the machinery to the finance company.

However, Jo also holds the machinery as it is attached to her land. She is entitled to a deduction for the decline in value of it based on the cost to her of holding the machinery. This cost would not include her lease payments but would include the cost of installing the machinery. For more information about what amounts form part of the cost of a depreciating asset, see **The cost of a depreciating asset** on page 14.

Depreciating assets which improve or are fixed to leased land

If a depreciating asset is fixed to leased land and the lessee has a right to remove it, the lessee is the holder for the time that the right to remove the asset exists.

EXAMPLE: Holder of depreciating asset fixed to leased land

Jo leases land from Bill, who owns the land. Jo purchases some machinery and fixes it to the land. Under property law, the machinery is treated as part of the land so Bill is its legal owner.

However, under the terms of her lease, Jo can remove the machinery from the land at any time. Because she has acquired and fixed the machinery to the land and has a right to remove it, Jo is the holder of the machinery for the time that the right to remove it exists.

If a lessee or owner of certain other rights over land (for example, an easement) improves the land with a depreciating asset, that person is the holder of the asset if the asset is for their own use, even though they have no right to remove it from the land. They remain the holder for the time that the lease or right exist.

EXAMPLE: Holder of depreciating asset that improves leased land

Jo leases land from Bill to use for farming. Jo installs an irrigation system on the land which is an improvement to the land. While Bill is the legal owner under property law as the irrigation system is part of his land, Jo is the holder of the irrigation system. Even though she has no right to remove the irrigation system under her contract with Bill, Jo may deduct amounts for its decline in value for the term of the lease because:

- she improved the land, and
- the improvement is for her use.

Partnership assets

The partnership (not the partners or any particular partner) is taken to be the holder of a partnership asset, regardless of its ownership. A partnership asset is one held and applied by the partners exclusively for the purposes of the partnership and in accordance with the partnership agreement.

WORKING OUT DECLINE IN VALUE

You workout deductions for the decline in value of most depreciating assets, including those acquired before 1 July 2001, under UCA.

UCA contain general rules for working out the decline in value of a depreciating asset, and those rules are covered in this part of the guide. Transitional rules apply to depreciating assets held before 1 July 2001 so you can work out their decline in value using these rules; see **Depreciating assets held before 1 July 2001** on page 8.

The general rules do not apply to some depreciating assets. UCA provide specific rules for working out deductions for the assets listed below:

- certain depreciating assets that cost $300 or less and that are used mainly to produce non-business assessable income; see **Immediate deduction for certain non-business depreciating assets (costing $300 or less)** on page 10
- certain depreciating assets that cost or are written down to less than $1,000; see **Low-value pools** on page 22
- in-house software for which expenditure has been allocated to a software development pool; see **Software development pools** on page 25
- depreciating assets used in exploration or prospecting; see **Mining and quarrying, and minerals transport** on page 32
- water facilities, fencing assets, fodder storage assets and horticultural plants (including grapevines); see **Primary production depreciating assets** on page 27
- certain depreciating assets of primary producers, other landholders and rural land irrigation water providers used in landcare operations; see **Landcare operations** on page 31
- certain depreciating assets of primary producers and other landholders used for electricity connections or phone lines; see **Electricity connections and phone lines** on page 32
- trees in a carbon sink forest; see **Carbon sink forests** on page 36.

There are also specific rules for working out notational deductions for depreciating assets used in carrying on research and development activities; see *Research and development tax incentive schedule instructions 2020* (NAT 6709).

When does a depreciating asset start to decline in value?

The decline in value of a depreciating asset starts when you first use it, or install it ready for use, for any purpose, including a private purpose. This is known as a depreciating asset's **start time**.

Although an asset is treated as declining in value from its start time, a deduction for its decline in value is only allowable to the extent it is used for a taxable purpose; see **Definitions** on page 40.

If you initially use a depreciating asset for a non-taxable purpose, such as for a private purpose, and in later years use it for a taxable purpose, you need to work out the asset's decline in value from its start time, including the years you used it for a private purpose. You can then work out your deductions for the decline in value of the asset for the years you used it for a taxable purpose; see **Decline in value of a depreciating asset used for a non-taxable purpose** on page 8.

Methods of working out decline in value

You generally have the choice of two methods to work out the decline in value of a depreciating asset. These are:

- the prime cost method or
- the diminishing value method.

Both these methods are based on a depreciating asset's effective life. The rules for working out an asset's effective life are explained in **Effective life of a depreciating asset** on page 12.

You can generally choose to use either method for each depreciating asset you hold. However, once you have chosen a method for a particular asset, you **cannot** change to the other method for that asset.

The *Depreciation and capital allowance tool* at **ato.gov.au** will help you with the choice and the calculations.

If you were carrying on a business in 2019–20, you may have the option of using the **instant asset write off**, on page 9, or go to **ato.gov.au** and search for *Backing business investment – accelerated depreciation*.

You do not need to make the choice where you can claim an immediate deduction for the asset, for example, certain depreciating assets that cost $300 or less; see **Immediate deduction for certain non-business depreciating assets (costing $300 or less)** on page 10.

In other cases, you do not have a choice of which method you use to work out the decline in value. These cases are:

- If you acquire intangible depreciating assets such as in-house software, certain items of intellectual property, spectrum licences, datacasting transmitter licences and telecommunications site access rights, you must use the prime cost method.
- If you acquire a depreciating asset from an associate who has deducted or can deduct amounts for the decline in value of the asset, see **Depreciating asset acquired from an associate** on page 9
- If you acquire a depreciating asset but the user of the asset does not change or is an associate of the former user, for example, under sale and leaseback arrangements, see **Sale and leaseback arrangements** on page 9
- If there has been rollover relief, see **Rollover relief** on page 21
- If the asset has been allocated to a low-value pool or software development pool, the decline in value is calculated at a statutory rate, see **Software development pools** on page 25, and **Low-value pools** on page 22.

By working out the decline in value you determine the **adjustable value** of a depreciating asset. A depreciating asset's adjustable value at a particular time is its cost (first and second elements) less any decline in value up to that time. See **The cost of a depreciating asset** on page 14 for information on first and second elements of cost. The opening adjustable value of an asset for an income year is generally the same as its adjustable value at the end of the previous income year.

You calculate the decline in value and adjustable value of a depreciating asset from the asset's start time independently of your use of the depreciating asset for a taxable purpose. However, your deduction for the decline in value is reduced by the extent that your use of the asset is for a non-taxable purpose; see **Decline in value of a depreciating asset used for a non-taxable purpose** on page 8. Your deduction may also be reduced if the depreciating asset is a leisure facility or boat even though the asset is used, or installed ready for use, for a taxable purpose; see **Decline in value of leisure facilities** on page 9, and **Decline in value of boats** on page 9.

The diminishing value method

The diminishing value method:

- assumes the decline in value each income year is a constant percentage of the base value each year for the effective life of the asset, and therefore,
- produces a progressively smaller decline in the item's value over time.

Did you hold the depreciating asset before 10 May 2006?

- **Yes** For depreciating assets you held **before** 10 May 2006, the formula for the decline in value is:

$$\textbf{base value} \times \frac{\textbf{days held}}{365} \times \frac{150\%}{\text{asset's effective life}}$$

Use this formula for any asset you held before 10 May 2006, even if you disposed of it and reacquired it on or after 10 May 2006.

- **No** For depreciating assets you started to hold **on or after** 10 May 2006 the formula for the decline in value is:

$$\textbf{base value} \times \frac{\textbf{days held}}{365} \times \frac{200\%}{\text{asset's effective life}}$$

The base value:

- for the income year in which an asset's start time occurs, is the asset's cost
- for a later income year, is
  - the asset's opening adjustable value for that year, plus
  - any amount included in the asset's **second element of cost** for that year.

Days held is the number of days you held the asset in the income year in which:

- you used it, or
- you had it installed ready for use for any purpose.

Days held:

- can be 366 for a leap year, even though the denominator remains 365
- is the number of days you held the asset during the income year
  - from its starting date in the income year in which the asset's start occurs
  - until its ending date in the income year in which the asset's end-of-life occurs.

For information about balancing adjustment events, see **What happens if you no longer hold or use a depreciating asset?** on page 17.

You cannot use the diminishing value method to work out the decline in value of:
- in-house software
- an item of intellectual property (except copyright in a film)
- a spectrum licence
- a datacasting transmitter licence, or
- a telecommunications site access right.

EXAMPLE: An asset's base value for its first and its second income years ignoring any GST impact

Leo purchased a computer for $4,000. The computer's base value in its first income year, which is when the computer is first used, is its cost of $4,000. If the computer's decline in value for that first income year is $1,000, and no amounts are included in the second element of the computer's cost, its base value for the second income year is its opening adjustable value of $3,000, that is, the cost of the computer ($4,000) less its decline in value ($1,000).

EXAMPLE: Diminishing value method, ignoring any GST impact

Laura purchased a photocopier on 1 July 2019 for $1,500 and she started using it that day. It has an effective life of five years.
Laura chose to use the diminishing value method to work out the decline in value of the photocopier. The decline in value for 2019–20 is $602, worked out as follows:

$$1{,}500 \times \frac{366}{365} \times \frac{200\%}{5}$$

If Laura used the photocopier wholly for taxable purposes in 2019–20, she is entitled to a deduction equal to the decline in value. The adjustable value of the asset on 30 June 2020 is $898. This is the cost of the asset ($1,500) less its decline in value to 30 June 2020 ($602).

The prime cost method

The prime cost method:
- assumes the value of a depreciating asset decreases constantly over its effective life, and therefore,
- produces a consistent decline in the item's value over time.

The formula for the annual decline in value using the prime cost method is:

$$\textbf{asset's cost} \times \frac{\textbf{days held}}{365} \times \frac{100\%}{\text{asset's effective life}}$$

The **value of the asset's cost** decreases every year by a constant amount. That constant amount is the actual cost divided by the number of years of effective life. In the first year, the value of the asset's cost is the actual cost of the asset.

- If your asset cost $2,000 and has an effective life of five years, you can claim one fifth, 20%, of its cost, that is $400, in each of the five years.

Days held is the number of days you held the asset in the income year in which:
- you used it, or
- you had it installed ready for use for any purpose.

Days held:
- can be 366 for a leap year, even though the denominator remains 365
- is the number of days you held the asset during the income year
  - from its starting date in the income year in which the asset's start occurs
  - until its ending date in the income year in which the asset's end-of-life occurs.

For information about balancing adjustment events, such as the start and end dates, see **What happens if you no longer hold or use a depreciating asset?** on page 17.

EXAMPLE: Prime cost method, ignoring any GST impact

Laura purchased a photocopier on 1 July 2019 for $1,500 and she started using it that day. It has an effective life of five years. Laura chose to use the prime cost method to work out the decline in value of the photocopier.
The decline in value for 2019–20 is $301, worked out as follows:

$$1{,}500 \times \frac{366}{365} \times \frac{100\%}{5}$$

If Laura used the photocopier wholly for taxable purposes in 2019–20, she is be entitled to a deduction equal to the decline in value. The adjustable value of the asset at 30 June 2020 is $1,199.

If there has been rollover relief and the transferor used the prime cost method to work out the asset's decline in value, the transferee should replace the asset's effective life in the prime cost formula with the asset's remaining effective life, that is, any period of the asset's effective life that is yet to elapse when the transferor stopped holding the asset; see **Rollover relief** on page 21.

An adjusted prime cost formula must be used if any of the following occurs:
- you recalculate the effective life of an asset; see **Effective life of a depreciating asset** on page 12
- an amount is included in the second element of an asset's cost in an income year after the initial income year in which the asset's start time occurs; see **The cost of a depreciating asset** on page 14
- an asset's opening adjustable value is reduced by a debt forgiveness amount; see **Commercial debt forgiveness** on page 17
- you reduced the opening adjustable value of a depreciating asset that is the replacement asset for an asset subject to an involuntary disposal; see **Involuntary disposal of a depreciating asset** on page 21
- an asset's opening adjustable value is modified due to GST increasing or decreasing adjustments, input tax credits for the acquisition or importation of the asset, or input tax credits for amounts included in the second element of cost of an asset; see **GST input tax credits** on page 15, or
- an asset's opening adjustable value is modified due to forex realisation gains or forex realisation losses; see **Foreign currency gains and losses** on page 17.

You must use the adjusted prime cost formula for the income year in which any of these changes are made (the 'change year') and later years. Where the asset's remaining effective life is any period of its effective life that is yet to elapse either at the start of the change year or, in the case of roll-over relief, when the balancing adjustment event occurs for the transferor.The formula for the decline in value is:

$$\text{opening adjustable value for the change year plus any second element of cost amounts for that year} \times \frac{\text{days held}}{365} \times \frac{100\%}{\text{asset's remaining effective life}}$$

The prime cost formula must also be adjusted for certain intangible depreciating assets you acquire from a former holder; see **Effective life of intangible depreciating assets** on page 13.

Depreciating assets held before 1 July 2001

To work out the decline in value of depreciating assets you held before 1 July 2001, you generally use the same cost, effective life and method that you were using under the former law.

The undeducted cost of the asset at 30 June 2001 becomes its opening adjustable value at 1 July 2001.

You work out the undeducted cost of the asset under the former depreciation rules. It is the asset's cost less the depreciation for the asset up to 30 June 2001, assuming that you used it wholly for producing assessable income.

For a spectrum licence, a depreciating asset that is an item of intellectual property and certain depreciating assets used in mining, quarrying or minerals transport, the opening adjustable value at 1 July 2001 is the amount of unrecouped expenditure for the asset at 30 June 2001. These assets do not have an undeducted cost under the former rules.

Special transitional rules apply to plant for which you used accelerated rates of depreciation before 1 July 2001 or could have used accelerated rates had you used the plant, or had it installed ready for use, for producing assessable income before that day. These rules ensure that accelerated rates continue to apply under UCA; see **Accelerated depreciation** below.

Accelerated depreciation

For plant acquired between 27 February 1992 and 11.45am AEST on 21 September 1999, accelerated rates of depreciation and broadbanding were available. The rates were based on effective life adjusted by a loading of 20% and broadbanded into one of seven rate groups. The loading, together with the broadbanding, produced accelerated rates of depreciation.

Measures introduced in March 2020 provide an incentive for businesses with aggregated turnover of less than $500 million to deduct the cost of depreciating assets at an accelerated rate in 2019–20 and 2020–21. See **Backing Business Investment** on page 10.

From 12 March 2020, generally, accelerated rates of depreciation have not been available for plant acquired after 11.45am AEST on 21 September 1999. To be taken to be plant acquired before that time, the plant must have been:

- acquired under a contract entered into before that time
- constructed, with construction starting before that time, or
- acquired in some other way before that time.

However, small business taxpayers have been able to continue to use accelerated rates for plant acquired after 21 September 1999 but before 1 July 2001 if they met certain conditions when the plant was first used or installed ready for use.

Small business taxpayers have not been able to use accelerated rates of depreciation for assets they:

- started to hold under a contract entered into after 30 June 2001
- constructed, with construction starting after 30 June 2001, or
- started to hold in some other way after 30 June 2001.

You continue to use accelerated rates to work out the decline in value under UCA if:

- you used accelerated rates of depreciation for an item of plant before 1 July 2001, or
- you could have used accelerated rates had you used the plant, or had you had it installed ready for use, for producing assessable income before that day.

You replace the effective life component in the formula for working out the decline in value with the accelerated rate you were using. For a list of **Accelerated rates of depreciation** see page 41.

EXAMPLE: Working out decline in value using accelerated rates of depreciation, ignoring any GST impact

Peter purchased a machine for use in his business for $100,000 on 1 July 1999.

As the machine was acquired before 21 September 1999, Peter can use accelerated rates of depreciation to calculate his deductions. Using the prime cost method, a depreciation rate of 7% applies as the machine has an effective life of 30 years.

To work out his deduction for 2019–20, Peter continues to use the same cost, method and rate that he was using before the start of UCA.

The decline in value of the machine for 2019–20 is $7,019, worked out as follows:

$$\text{asset's cost} \times \frac{\text{days held}}{365} \times \text{prime cost rate}$$

$$100{,}000 \times \frac{366}{365} \times 7\%$$

Decline in value of a depreciating asset used for a non-taxable purpose

You calculate the decline in value and adjustable value of a depreciating asset from the start time independently of your use of the depreciating asset for a taxable purpose. However, you reduce your deduction for the decline in value by the extent that your use of the asset is for a non-taxable purpose.

If you initially use an asset for a non-taxable purpose, such as for a private purpose, and in later years use it for a taxable purpose, you need to work out the asset's decline in value from its start time including the years you used it for a private purpose. You can then work out your deductions for the decline in value of the asset for the years you used it for a taxable purpose.

EXAMPLE: Depreciating asset used partly for a taxable purpose, ignoring any GST impact

> Leo bought a computer for $6,000 on 1 July 2019. He only used it for a taxable purpose 50% of the time during 2019–20.
>
> If the computer's decline in value for 2019–20 is $1,500, Leo's deduction is reduced to $750, that is, 50% of the computer's decline in value for 2019–20.
>
> The adjustable value on 30 June 2020 is $4,500 (that is, $6,000 – $1,500), irrespective of the extent of Leo's use of the computer for taxable purpose.

EXAMPLE: Depreciating asset initially used for a non-taxable purpose

> Paul purchased a refrigerator on 1 July 2017 and immediately used it wholly for private purposes. He started a new business on 1 March 2020 and then used the refrigerator wholly in his business. Paul's refrigerator started to decline in value from 1 July 2017 as that was the day he first used it. He needs to work out the refrigerator's decline in value from that date. However, Paul can only claim a deduction for the decline in value for the period commencing 1 March 2020 when he used the refrigerator for a taxable purpose.

Decline in value of leisure facilities

Your deduction for the decline in value of a leisure facility may be reduced even though you use it, or install it ready for use, for a taxable purpose. Your deduction is limited to the extent that:

- the asset's use is a fringe benefit, or
- the leisure facility is used (or held for use) mainly in the ordinary course of your business of providing leisure facilities for payment, to produce your assessable income in the nature of rents or similar charges, or for your employees' use or the care of their children.

Decline in value of boats

The total amount you can claim as a deduction for the decline in value of a boat that you use or hold cannot exceed your assessable income from using or holding that boat in 2019–20. If the total amount of your deduction exceeds the relevant assessable income, we reduce the deduction by the amount of the excess.

Exceptions to that reduction are:

- holding a boat as your trading stock
- using a boat (or holding it) mainly for letting it on hire in the ordinary course of a business that you carry on
- using a boat (or holding it) mainly for transporting the public or goods for payment in the ordinary course of a business that you carry on, or
- using a boat for a purpose that is essential to the efficient conduct of a business that you carry on.

Depreciating asset acquired from an associate

If you acquired plant on or after 9 May 2001 or another depreciating asset on or after 1 July 2001 from an associate, such as a relative or partner, and the associate claimed or can claim deductions for the decline in value of the asset, you must use the same method of working out the decline in value that the associate used.

If the associate used the diminishing value method, you must use the same effective life that they used. If they used the prime cost method you must use any remaining period of the effective life used by them.

You must recalculate the effective life of the depreciating asset if the asset's cost increases by 10% or more in any income year, including the year in which you start to hold it; see **How to recalculate effective life** on page 14.

You can require the associate to tell you the method and effective life they used by serving a notice on them within 60 days after you acquire the asset. Penalties can be imposed if the associate intentionally refuses or fails to comply with the notice.

Sale and leaseback arrangements

If you acquired plant on or after 9 May 2001 or another depreciating asset after 1 July 2001 but the user of the asset does not change or is an associate of the former user, such as under a sale and leaseback arrangement, you must use the same method of working out the decline in value that the former holder used.

If the former holder used the diminishing value method, you must use the effective life that they used. If they used the prime cost method, you must use any remaining period of the effective life used by them. If you cannot readily ascertain the method that the former holder used or if they did not use a method, you must use the diminishing value method. You must use an effective life determined by the Commissioner if you cannot find out the effective life that the former holder used or if they did not use an effective life.

You must recalculate the effective life of the depreciating asset if the asset's cost increases by 10% or more in any income year, including the year in which you start to hold it; see **How to recalculate effective life** on page 14.

Instant asset write-off

Medium sized businesses with an aggregated turnover from $10 million and less than $50 million are now eligible for the instant asset write-off. This applies to assets costing less than $30,000 each, purchased and first used or installed ready for use from 7.30pm (AEDT) 2 April 2019 to 11 March 2020.

From 12 March 2020 the instant asset write off was further extended to businesses with an aggregated turnover under $500 million for assets costing less than $150,000 and first used or installed ready for use from 12 March 2020 to 30 June 2020. For further information see **Instant asset write off** on page 36.

The car limit applies to limit the instant asset write off deduction where a car is designed to mainly carry passengers.

For assets purchased costing more than the relevant threshold, then the general depreciation rules must be used.

- Small businesses also have access to the increased threshold. Different thresholds apply at different times of the year. See **Small business entities** on page 36.

Backing business investment

Measures introduced in March 2020 provide an incentive for businesses with **aggregated turnover** of less than $500 million to deduct the cost of depreciating assets at an accelerated rate in 2019–20 and 2020–21.

To be eligible to apply the accelerated rate of deduction, the depreciating asset must:

- be new and not previously held by another entity (other than as trading stock)
- be first held on or after 12 March 2020
- be first used, or first installed ready for use, for a taxable purpose on or after 12 March 2020 to 30 June 2021
- not be an asset to which an entity has applied the instant asset write-off rules or depreciation deductions.

The amount you can deduct in the income year the asset is first used, or installed ready for use, is:

- 50% of the cost (or adjustable value where applicable) of the depreciating asset, plus
- the amount of the usual depreciation deduction that would otherwise apply on the remaining 50% of the cost of the depreciating asset.

Small businesses also have access to the accelerated rate of depreciation. See **Small business entities** on page 36.

For more information, go to **ato.gov.au** and search for 'Backing business investment accelerated depreciation'.

IMMEDIATE DEDUCTION FOR CERTAIN NON-BUSINESS DEPRECIATING ASSETS (COSTING $300 OR LESS)

The decline in value of certain depreciating assets costing $300 or less is their cost. This means you get an immediate deduction for the cost of the asset to the extent that you used it for a taxable purpose during the income year in which the deduction is available.

The immediate deduction is available if all of the following tests are met for asset:

- it cost $300 or less; see **Cost is $300 or less**
- you used it mainly for the purpose of producing assessable income that was not income from carrying on a business; see **Used mainly to produce non-business assessable income** in the next column
- it was not part of a set of assets you started to hold in the income year that cost more than $300; see **Not part of a set** on page 11, **and**
- it was not one of a number of identical or substantially identical assets you started to hold in the income year that together cost more than $300; see **Not one of a number of identical or substantially identical items** on page 11.

If you are not eligible to claim the immediate deduction, you work out the decline in value of the asset using the general rules for working out decline in value. Alternatively, you may be able to allocate the asset to a low-value pool; see **Low-value pools** on page 22.

This immediate deduction is not available for the following depreciating assets:

- certain water facilities, fencing assets, fodder storage assets and horticultural plants, including grapevines; see **Primary production depreciating assets** on page 27
- certain depreciating assets of primary producers, other landholders and rural land irrigation water providers used in landcare operations; see **Landcare operations** on page 31
- certain depreciating assets of primary producers and other landholders used for electricity connections or phone lines; see **Electricity connections and phone lines** on page 32
- in-house software if you have allocated expenditure on it to a software development pool; see **Software development pools** on page 25.

The amount of the immediate deduction may need to be reduced if the changes which limit deductions for decline in value of certain second-hand depreciating assets in residential rental properties apply to the asset; see **Second-hand depreciating assets in residential rental properties** on page 3.

Cost is $300 or less

If you are entitled to a GST input tax credit for the asset, the cost is reduced by the input tax credit before determining whether the cost is $300 or less.

If you hold an asset jointly with others and the cost of your interest in the asset is $300 or less, you can claim the immediate deduction even though the depreciating asset in which you have an interest costs more than $300; see **Jointly held depreciating assets** on page 15.

EXAMPLE: Cost is $300 or less, ignoring any GST impact

John, Margaret and Neil jointly own a rental property in the proportions of 50%, 25% and 25%. Based on their respective interests, they contribute $400, $200 and $200 to acquire a new refrigerator for the rental property. Margaret and Neil can claim an immediate deduction because the cost of their interest in the refrigerator does not exceed $300. John cannot claim an immediate deduction because the cost of his interest is more than $300.

Used mainly to produce non-business assessable income

Some examples of depreciating assets used to produce non-business income are:

- a briefcase or tools of trade used by an employee
- freestanding furniture in a residential rental property that was purchased as new after 9 May 2017 and had never been used previously
- a calculator used in managing an investment portfolio.

To claim the immediate deduction, you must use the depreciating asset more than 50% of the time for producing non-business assessable income.

If you meet this test, you can use the asset for other purposes (such as to carry on a business) and still claim the deduction. However, if you use the asset mainly for producing non-business assessable income but you also use the asset for a non-taxable purpose, then the amount of deduction must be reduced by the amount attributable to the use for a non-taxable purpose.

EXAMPLE: Depreciating asset used mainly to produce non-business assessable income, ignoring any GST impact

Rob buys a calculator for $150. The calculator is used 40% of the time by him in his business and 60% of the time for managing his share portfolio. As the calculator is used more than 50% of the time for producing non-business assessable income, he can claim an immediate deduction for it of $150.

If Rob used his calculator 40% of the time for private purposes and 60% of the time for managing his share portfolio, he is still using the calculator more than 50% of the time for producing non-business assessable income. However, his deduction would be reduced by 40% to reflect his private use of the asset.

Not part of a set

You need to determine whether items form a set on a case-by-case basis. You can regard items as a set if they are:

- dependent on each other
- marketed as a set, or
- designed and intended to be used together.

It is the cost of a set of assets you acquire in the income year that must not exceed $300. You cannot avoid the test by buying parts of a set separately.

EXAMPLE: Set of items, ignoring any GST impact

In 2019–20, Paula, a primary school teacher, bought a series of six progressive reading books costing $65 each. The books are designed so that pupils move on to the next book only when they have successfully completed the previous book. The books are marketed as a set and are designed to be used together. The six books would be regarded as a set. Paula cannot claim an immediate deduction for any of these books because they form part of a set which she acquired in the income year, and the total cost of the set was more than $300.

EXAMPLE: Not a set, ignoring any GST impact

Marie, an employee, buys a range of tools for her tool kit for work (a shifting spanner, a boxed set of screwdrivers and a hammer). Each item costs $300 or less. While the tools add to Marie's tool kit, they are not a set. It would make no difference if Marie purchased the items at the same time and from the same supplier or manufacturer. An immediate deduction is available for all the items, including the screwdrivers. The screwdrivers are a set as they are marketed and used as a set. However, as the cost is $300 or less, the deduction is available.

A group of assets acquired in an income year can be a set in themselves even though they also form part of a larger set acquired over more than one income year. If the assets acquired in an income year are a set then the total cost of that set must not exceed $300. Assets acquired in another income year that form part of a larger set are not taken into account when working out the total cost of a set and whether items form a set.

EXAMPLE: Set of items part of a larger set, ignoring any GST impact

In 2019–20, Paula, a primary school teacher, hears about a series of 12 progressive reading books. The books are designed so that pupils move on to the next book only when they have successfully completed the previous book. The first six books are at a basic level while the second six are at an advanced level.

Paula buys one book a month beginning in January and by 30 June 2020 she holds the first six books (the basic readers) at a total cost of $240. Because of the interdependency of the books, the six books are a set even though they can be purchased individually and they form part of a larger set. An immediate deduction is available for each book because the cost of the set Paula acquired during the income year was not more than $300.

If Paula acquires the other six books (the advanced readers) in the following income year, they would be regarded as a set acquired in that year.

The concept of a set requires more than one depreciating asset. In some cases, however, more than one item may be a single depreciating asset. An example would be a three-volume dictionary. This is a single depreciating asset, not a set of three separate depreciating assets, as the three volumes have a single integrated function.

Not one of a number of identical or substantially identical items

Items are identical if they are the same in all respects. Items are substantially identical if they are the same in most respects even though there may be some minor or incidental differences. Factors to consider include colour, shape, function, texture, composition, brand and design.

The total cost of the asset and any other identical or substantially identical asset that you acquire in the income year must not exceed $300. Do not take into account assets that you acquired in another income year.

EXAMPLE: Substantially identical items, ignoring any GST impact

Jan buys three new kitchen stools for her rental property in 2019–20. The stools are all wooden and of the same design but they are different colours. The colour of the stools is only a minor difference which is not enough to conclude that the stools are not substantially identical.

The stools cost $150 each. Jan cannot claim an immediate deduction for the cost of each individual stool because they are substantially identical and the total cost of the three stools exceeds $300.

EXAMPLE: Not substantially identical items

Jan also buys some new chairs for her rental property: a canvas chair for the patio, a high-back wooden chair for the bedroom dressing table and a leather executive chair for the study. While these are all chairs, they are not identical or substantially identical. Jan can claim the cost of each chair as an immediate deduction if the chair costs $300 or less.

EFFECTIVE LIFE OF DEPRECIATING ASSETS

Generally, the effective life of a depreciating asset is how long it can be used by any entity for a taxable purpose or for the purpose of producing exempt income or non-assessable non-exempt income:

- having regard to the wear and tear you reasonably expect from your expected circumstances of use
- assuming that it will be maintained in reasonably good order and condition, and
- having regard to the period within which it is likely to be scrapped, sold for no more than scrap value or abandoned.

Effective life is expressed in years, including fractions of years. Effective life is not rounded to the nearest whole year.

Choice of determining effective life

For most depreciating assets, you have the choice of either working out the effective life yourself or using an effective life determined by the Commissioner.

You must make the choice for the income year in which the asset's start time occurs. Generally, you must make the choice by the time you lodge your income tax return for that year.

However, the choice is not available:

- for most intangible depreciating assets; see **Effective life of intangible depreciating assets** on page 13
- if a depreciating asset was acquired from an associate who claimed or could have claimed deductions for the asset's decline in value; see **Depreciating asset acquired from an associate** on page 9
- for a depreciating asset that you started to hold but the user of the asset did not change or is an associate of the former user, for example, under a sale and leaseback arrangement; see **Sale and leaseback arrangements** on page 9
- if there has been rollover relief; see **Rollover relief** on page 21.

Working out the effective life yourself

Subject to the exclusions above, you can work out the asset's effective life yourself, by determining how many years it will **reasonably be expected** to produce income given the specific way it's likely to be used. The sort of information that you could use to make an estimate of the effective life of an asset includes:

- the physical life of the asset
- engineering information
- the manufacturer's specifications
- your own past experience with similar assets
- the past experience of other users of similar assets
- the level of repairs and maintenance commonly adopted by users of the asset
- retention periods
- scrapping or abandonment practices.

You work out the effective life of a depreciating asset from the asset's start time.

Commissioner's determination

In making his determination, the Commissioner assumes that the depreciating asset is new and has regard to general industry circumstances of use.

As a general rule, use the Taxation Ruling or version of the Taxation Ruling schedule that is in force at the time you first use it, or have it installed ready for use. This will usually be when you:

- enter into a contract to acquire an asset
- otherwise acquire it, or
- start to construct it.

However, if the asset's start time does not occur within five years of this time, you must use the effective life that is in force at the asset's start time. For an item of plant acquired under a contract entered into, otherwise acquired or started to be constructed before 11.45am AEST on 21 September 1999, there is no restriction on the period within which the plant must be used. The general rule in the previous paragraph applies to such plant.

The latest Taxation Ruling at the time of publication of this guide is *Taxation Ruling TR 2019/5 – Income tax: effective life of depreciating assets (applicable from 1 July 2019)*, which lists the Commissioner's determinations of the effective life for various depreciating assets.

You need to work out which effective life ruling applies. You use the life applicable on the date you first used the depreciating asset or had it installed ready for use for any purpose. You may have to use a previous effective life ruling. For more information, go to **ato.gov.au** and search for 'Capital allowances: effective life – rulings, law and objections'.

Statutory caps on the Commissioner's determination of effective life

From 1 July 2002 there are statutory caps on the Commissioner's determined effective life for certain depreciating assets. This means if you choose to use the Commissioner's determination of effective life for an asset subject to a capped life, you must use the capped life if it is shorter than the Commissioner's determination.

Assets with capped lives include aeroplanes; helicopters; certain shipping vessels, certain buses, light commercial vehicles, trucks and trailers; and certain assets used in the oil and gas industries. For more information, see Taxation Ruling TR 2019/5.

Effective life of intangible depreciating assets

The effective life of most intangible depreciating assets is prescribed under UCA.

Item number	Asset	Effective life in years
1	Standard patent	20
2	Innovation patent	8
3	Petty patent	6
4	Registered design	15
5	Copyright (except copyright in a film)	The shorter of 25 years from when you acquire it or the period until the copyright ends
6	A licence (except one relating to a copyright or in-house software)	The term of the licence
7	A licence relating to a copyright (except copyright in a film)	The shorter of 25 years from when you become the licensee or the period until the licence ends
8	In-house software	5*
9	Spectrum licence	The term of the licence
10	Datacasting transmitter licence	15
14	Telecommunications site access right	The term of the right

* For more information see **In-house software** on page 25

You do not have the choice of either working out the effective life yourself or using an effective life determined by the Commissioner for the intangible depreciating assets in the table above and other intangible depreciating assets. In addition, the effective life of these depreciating assets cannot be recalculated.

The effective life of an indefeasible right to use a telecommunications cable system is the effective life of the telecommunications cable over which the right is granted.

The effective life of any other intangible depreciating asset (which is not an indefeasable right to use a telecommunications cable system or a mining, quarrying or prospecting right) cannot be longer than the term of the asset as extended by any reasonably assured extension or renewal of that term.

If you acquired any of the intangible assets listed in the above table (except items 5, 7 or 8) from a former holder and you choose to calculate the asset's decline in value using the prime cost method, in the formula you must use the number of years remaining in that effective life at the start of the income year you acquired the asset, not the effective life shown in the table.

Effective life of intangible depreciating assets that are mining, quarrying or prospecting rights, or mining, quarrying or prospecting information

The effective life of a mining, quarrying or prospecting right or mining, quarrying or prospecting information is provided in the table below:

Asset	Effective life in years
A mining, quarrying or prospecting right or mining, quarrying or prospecting information, relating to mining and quarrying operations (except obtaining petroleum or quarry materials)	The life of the mine or proposed mine to which the right or information relates or, if there is more than one, the life of the mine that has the longest estimated life
A mining, quarrying or prospecting right or mining, quarrying or prospecting information, relating to mining and quarrying operations to obtain petroleum	The life of the petroleum field or proposed petroleum field to which the right or information relates or, if there is more than one, the life of the petroleum field that has the longest estimated life
A mining, quarrying or prospecting right or mining, quarrying or prospecting information, relating to mining and quarrying operations to obtain quarry materials	The life of the quarry or proposed quarry to which the right or information relates or, if there is more than one, the life of the quarry that has the longest estimated life

If you acquire a mining, quarrying or prospecting right or mining, quarrying or prospecting information listed in the above table, you will need to work out the effective life yourself.

For example, for a mining, quarrying or prospecting right relating to mining and quarrying operations, you will do this by estimating the period until the end of the life of the mine or proposed mine to which the right relates or, if there is more than one such mine, the life of the mine that has the longest estimated life. You work out this period:

- from the start time of the mining, quarrying or prospecting right, and
- by reference only to the period of time over which the reserves, reasonably estimated using an appropriate accepted industry practice, are expected to be extracted from the mine, petroleum field or quarry.

You will have a choice of using either the prime cost or diminishing value method to work out the decline in value of the mining, quarrying or prospecting right.

However, the effective life of a mining, quarrying or prospecting right, or mining, quarrying or prospecting information, is 15 years if the right or information does not relate to:

- a mine or proposed mine
- a petroleum field or proposed petroleum field, or
- a quarry or proposed quarry.

You will also be able to choose to recalculate the effective life of a mining, quarrying or prospecting right or mining, quarrying or prospecting information if the effective life you have been using is no longer accurate because of changed circumstances.

Some examples of circumstances that could cause a variation include:

- a considerable structural price change for the mineral being extracted which leads to the mine's premature permanent closure
- previously uneconomically mineable geologies becoming economically mineable
- a noticeable improvement in extraction methods or transport arrangements from the mine which leads to faster extraction of the mineral and a consequential shortening of the remaining life of the mine
- new information becoming available as a result of further exploration or prospecting on the mining tenement as to the presence of minerals likely to be recoverable which leads to an increase in the remaining life of the mine
- a change to the accepted industry practice that affects the estimation of the life of the mine
- the right or information now relates to an existing or proposed mine, petroleum field or quarry, or
- the right or information no longer relates to an existing or proposed mine, petroleum field or quarry.

Choice of recalculating effective life

You may choose to recalculate the effective life of a depreciating asset if the effective life you have been using is no longer accurate because the circumstances relating to the nature of the asset's use have changed.

You can recalculate an asset's effective life each time those circumstances change. It can be done in any income year after the one in which the asset's start time occurs, and whether you worked out the previous effective life yourself or you used the effective life determined by the Commissioner.

Some examples of changed circumstances relating to the nature of the use of an asset are:

- your use of the asset turns out to be more or less rigorous than expected
- there is a downturn in the demand for the goods or services that the asset is used to produce that will result in the asset being scrapped
- legislation prevents the asset's continued use
- changes in technology make the asset redundant, or
- there is an unexpected demand, or lack of success, for a film.

You cannot choose to recalculate the effective life of any depreciating asset for which you:

- used accelerated rates of depreciation before 1 July 2001; see **Accelerated depreciation** on page 8, or
- could have used accelerated rates of depreciation before 1 July 2001, if you had used the asset to produce assessable income or had it installed ready for that use.

In addition, the effective life of certain intangible depreciating assets cannot be recalculated; see **Effective life of intangible depreciating assets** on the page 13.

Requirement to recalculate effective life

In some circumstances, you must recalculate the effective life of a depreciating asset.

You must recalculate the effective life of a depreciating asset if its cost is increased by 10% or more in an income year after the one in which its start time occurs and you either:

- worked out the effective life of the asset yourself, or
- used the Commissioner's determination of effective life (or a capped life) and the prime cost method to work out the asset's decline in value.

Even though you may be required to recalculate the effective life of an asset, you may conclude that the effective life remains the same.

You may also be required to recalculate the effective life of a depreciating asset:

- which you acquired from an associate who claimed or could have claimed deductions for the asset's decline in value; see **Depreciating asset acquired from an associate** on page 9, or
- for which you became the holder, where the user of the asset does not change or is an associate of the former user, for example, under a sale and leaseback arrangement; see **Sale and leaseback arrangements** on page 9.

How to recalculate effective life

You work out the recalculated effective life from the depreciating asset's start time. You use the same principles to recalculate the effective life of a depreciating asset that you would to work out the original effective life yourself; see **Working out the effective life yourself** on page 12.

Effect of recalculating effective life

If you recalculate the effective life of a depreciating asset, the new effective life starts to apply for the income year for which you make the recalculation.

If you are using the diminishing value method to work out the decline in value of a depreciating asset, you use the new estimate of effective life in the formula as the asset's effective life. Under the prime cost method, you must use the adjusted prime cost formula from the year for which you recalculate the asset's effective life; for information about the adjusted prime cost formula see **Methods of working out decline in value** on page 6.

THE COST OF A DEPRECIATING ASSET

To work out the decline in value of a depreciating asset, you need to know its cost.

Under UCA, the cost of a depreciating asset has two elements.

The **first element of cost** is, generally, amounts you are taken to have paid to hold the asset, such as the purchase price. It also includes amounts incurred after 30 June 2005 that you are taken to have paid for starting to hold the asset. The amounts must be directly connected with holding the asset.

The **first element of cost** is worked out as at the time you begin to hold the asset.

The **second element of cost** is, generally, amounts you are taken to have paid after that time to bring the asset to its present condition and location, such as a cost of improving the asset. It also includes expenses incurred after 30 June 2005 for a balancing adjustment event occurring for the asset (that is, costs incurred to stop holding or using the asset). For information on balancing adjustment events see **What happens if you no longer hold or use a depreciating asset?** on page 17. Such expenses may include advertising or commission expenses or the cost of demolishing the asset.

The first element cannot include an amount that forms part of the second element of another depreciating asset's cost. For example, if a depreciating asset is demolished so another depreciating asset can be installed on the same site, the demolition costs will form part of the second element of cost for the asset demolished. The amount is not also included in the first element of cost for the new asset.

EXAMPLE: First and second elements of cost, ignoring any GST impact

Terry wants to buy a vehicle for his business and the vehicle is not available in Australia. He locates a company in the United States from which he would be able to purchase the vehicle. He travels to the United States for the sole purpose of buying the vehicle and incurs travel costs of $5,000. Terry purchases the vehicle for $45,000.

The first element of cost is $50,000. This amount includes the purchase cost of the vehicle and the travel costs. The travel costs would be included in the first element of cost of the vehicle because they are directly connected with Terry starting to hold the vehicle. If Terry installs an alarm in the vehicle two months later at a cost of $1,500, that amount will be included in the second element of cost of the vehicle as the cost was incurred after he began to hold the vehicle.

For both first and second elements of cost of a depreciating asset, amounts you are taken to have paid include:

- an amount you pay
- the market value of a non-cash benefit you provide (for instance, in a salary sacrifice arrangement the market value is represented by the price paid by the employer under an arm's length arrangement. The employee can claim an amount for the decline in value, to the extent it is used for a taxable purpose)
- if you incur or increase a liability to pay an amount, the amount of the liability or increase
- if you incur or increase a liability to provide a non-cash benefit, the market value of the non-cash benefit or the increase
- if all or part of another's liability to pay you an amount is terminated, the amount of the liability or part terminated
- if all or part of another's liability to provide a non-cash benefit (except the depreciating asset) to you is terminated, the market value of the non-cash benefit or part terminated.

The cost of a depreciating asset does not include:

- amounts of input tax credits to which you are or become entitled; see **GST input tax credits** on page 15
- expenditure not of a capital nature, or
- any amount that you can deduct or that is taken into account in working out a deductible amount under provisions outside UCA.

EXAMPLE: Expenditure not of a capital nature and deductible outside UCA

Carolyn uses a motor vehicle for her business. As a result of Carolyn's use of the vehicle, she needs to replace the tyres. The cost of replacing the tyres is not included in the second element of the vehicle's cost because it would ordinarily be deductible under the repair provisions.

EXAMPLE: Expenditure not of a capital nature and deductible outside UCA

David operates a refrigerated truck as part of his business. David replaces the refrigeration unit in one of his trucks with a new unit (that performs the same function as the replaced unit). The replacement refrigeration unit is an integral part of the refrigerated van (that is located on a truck chassis) that is incapable of providing a useful function without the other part of the truck. The restoration of the effectiveness of the refrigeration truck by replacing the refrigeration unit is therefore a repair and not expenditure of a capital nature. The cost of replacing the refrigeration unit is not included in the second element of the truck's cost because it would ordinarily be deductible under the repairs provisions.

There are special rules to work out the cost of depreciating assets in certain circumstances. Some of the common cases are covered below. If you are not sure of the cost of a depreciating asset, contact us or your recognised tax adviser.

Jointly held depreciating assets

If a depreciating asset is held by more than one person, each holder works out their deduction for the decline in value of the asset based on the cost of their interest in the asset and not the cost of the asset itself.

GST input tax credits

If the acquisition or importation of a depreciating asset constitutes a creditable acquisition or a creditable importation, the cost of the asset is reduced by any input tax credit you are, or become, entitled to for the acquisition or importation. If you become entitled to the input tax credit in an income year after the one in which the asset's start time occurred, the asset's opening adjustable value is also reduced by the amount of the input tax credit.

If the cost of a depreciating asset is taken to be its market value (such as for assets acquired under a private or domestic arrangement), the market value is reduced by any input tax credit to which you would be entitled had the acquisition been solely for a creditable purpose.

Similarly, any input tax credit you are entitled to claim for the second element of a depreciating asset's cost reduces the cost of the asset. Its opening adjustable value is also reduced if you become entitled to the input tax credit in an income year after the one in which the asset's start time occurred.

Certain adjustments under the GST legislation reduce or increase the cost and, in some cases, the opening adjustable value of the asset. For example, these can commonly arise in the event of a change in price or because of the application of volume discounts. Other adjustments are treated as an outright deduction or income.

Car limit

Cars designed mainly for carrying passengers are subject to a car limit. If the first element of cost exceeds the car limit for the financial year in which you start to hold it, that first element of cost is reduced to the car limit.

The car limit for 2019–20 is $57,581.

Before applying the car limit you may need to:

- reduce the cost of the car by input tax credits; see **GST input tax credits** in the previous column
- increase the cost of the car if you acquired the car at a discount; see **Car acquired at a discount** below.

If a car with a cost exceeding the car limit is held by more than one person, the car limit is applied to the cost of the car and not to each holder's interest in the car. Once the car limit has been applied, the cost of the car (reduced to the car limit) is apportioned between each holder's interest. Each holder then works out their deduction for the decline in value of the car; see **Jointly held depreciating assets** above.

This car limit also applies under the luxury car lease rules; see **Leased luxury cars** on page 4.

The car limit does not apply in certain circumstances to some cars fitted out for transporting disabled people.

When a balancing adjustment event occurs for the car, the **termination value** must be adjusted under a special formula; see **Balancing adjustment rules for cars** on page 20.

Car acquired at a discount

If a car is acquired at a discount, the first element of its cost may be increased by the discount portion. The discount portion is any part of the discount that is due to the sale of another asset for less than market value, for example, a trade-in.

A car's cost is not affected by a discount obtained for other reasons.

Make the adjustment only if:

- the cost of the car (after GST credits or adjustments) plus the discount portion exceeds the car limit, and
- you, or another entity, have deducted or can deduct an amount for the other asset for any income year.

This rule does not apply to some cars fitted out for transporting disabled people.

When a balancing adjustment event occurs for the car, the termination value must be increased by the same discount portion; see **Balancing adjustment rules for cars** on page 20.

EXAMPLE: Car acquired at a discount, ignoring any GST impact

Kristine arranges to buy a $60,000 sedan for business use from Greg, a car dealer. She offers the station wagon she is using for this purpose, worth $20,000, as a trade-in. Greg agrees to reduce the price of the sedan to below the car limit if Kristine accepts less than market value for the trade-in. Kristine agrees to accept $15,000 for the trade-in and the price of the sedan is reduced to $55,000 (that is, a discount of $5,000).

The cost of the car plus the discount is more than the car limit so the first element of the car's cost is increased by the amount of the discount to $60,000. As the first element of cost then exceeds the car limit, it must be reduced to the car limit for the income year. The termination value of the wagon would be taken to be the market value of $20,000 as Kristine and Greg were not dealing at arm's length; see **Termination value** on page 18.

Non-arm's length and private or domestic arrangements

The first element of a depreciating asset's cost is the market value of the asset at the time you start to hold it if:

- the first element of the asset's cost would otherwise exceed its market value and you do not deal at arm's length with another party to the transaction, or
- you started to hold the asset under a private or domestic arrangement (for example, as a gift from a family member).

Similar rules apply to the second element of a depreciating asset's cost. For example, if something is done to improve your depreciating asset under a private or domestic arrangement, the second element of the asset's cost is the market value of the improvement when it is made.

The market value may need to be reduced for any input tax credits to which you would have been entitled; see **GST input tax credits** on page 15.

Note that there are special rules for working out the effective life and decline in value of a depreciating asset acquired from an associate, such as a spouse or partner; see **Depreciating asset acquired from an associate** on page 9.

Depreciating asset acquired with other property

If you pay an amount for a depreciating asset and something else, only that part of the payment that is reasonably attributable to the depreciating asset is treated as being paid for it. This applies to both the first and second elements of cost.

Apportionment on the basis of the market values of the various items for which the payment is made will generally be reasonable.

EXAMPLE: Apportionment of cost

Sam undertakes to pay an upholsterer $800 for a new desk and $300 to re-upholster a chair in a more durable material. He negotiates a trade discount of $100. The $1,000 paid should be apportioned between:

- the first element of cost of the desk, and
- the second element of cost of the chair

based on the relative market values of the desk and the labour and materials used to upholster the chair.

Hire purchase agreements

For income tax purposes, certain hire purchase agreements entered into after 27 February 1998 are treated as notional sale and loan transactions.

If the goods subject to the hire purchase agreement are depreciating assets and the hirer is the holder of the depreciating assets (see **Depreciating assets subject to hire purchase agreements** on page 4) the hirer may be entitled to deductions for the decline in value. Generally, the cost or value stated in the hire purchase agreement or the arm's length value is taken to be the cost of the depreciating assets.

Death of the holder

If a depreciating asset starts being held by you as a legal personal representative (say, as the executor of an estate) as a result of the death of the former holder, the cost of the asset to you is generally its adjustable value on the day the former holder died.

If the former holder allocated the asset to a low-value pool, the cost of the asset to you is the amount of the closing balance of the pool for the income year in which the former holder died that is reasonably attributable to the asset; see **Low-value pools** on page 22.

If you start to hold a depreciating asset because it passes to you as a beneficiary of an estate or as a surviving joint tenant, the cost of the asset to you is its market value when you started to hold it reduced by any capital gain that was ignored when the owner died or when it passed from the legal personal representative. See *Guide to capital gains tax 2020* (NAT 4151) for information about when these gains can be disregarded.

Commercial debt forgiveness

Generally, an amount that you owe is a commercial debt if you can claim a deduction for the interest paid on the debt or you would have been able to claim a deduction for interest if it had been charged. The amount of the commercial debt includes any accrued but unpaid interest.

If a commercial debt is forgiven, you may be required to make a reduction for a depreciating asset. If a reduction of the amount of deductible expenditure is made for a depreciating asset, the asset's cost is reduced by the debt forgiveness amount. If the reduction is made in a year later than the one in which the asset's start time occurs, the opening adjustable value of the asset is also reduced.

If an asset's opening adjustable value is reduced and you use the prime cost method to work out the asset's decline in value, you need to use the adjusted prime cost formula for the income year that the change is made and in later years; see **Methods of working out decline in value** on page 6.

Recoupment of cost

If you recoup an amount that you had previously included in the cost of a depreciating asset, you may need to include that recouped amount in your assessable income. An amount you receive for the sale of a depreciating asset at market value is not an assessable recoupment.

Foreign currency gains and losses

If you purchased a depreciating asset in foreign currency, the first element of the asset's cost is converted to Australian currency at the exchange rate applicable when you began to hold the asset, or when the obligation was satisfied, whichever occurred first.

From 1 July 2003, if the foreign currency amount became due for payment within the 24-month period that began 12 months before the time when you began to hold the depreciating asset, any realised foreign currency gain or loss (referred to as a forex realisation gain or a forex realisation loss) can modify the asset's cost, the opening adjustable value, or the opening balance of your low-value pool (as the case may be). Otherwise, that gain or loss is included in assessable income or allowed as a deduction, respectively.

If the foreign currency amount relates to the second element of the cost of a depreciating asset, the translation to Australian currency is made at the exchange rate applicable at the time you incurred the relevant expenditure. Here a 12-month rule applies instead of the 24-month rule. The 12-month rule requires that the foreign currency became due for payment within 12 months after the time you incurred the relevant expenditure. In some circumstances you may be able to elect that forex gains and losses do not modify the asset's cost, the opening adjustable value or the opening balance of your low-value pool. For more information, see *Foreign exchange (forex): election out of the 12 month rule* at **ato.gov.au**

WHAT HAPPENS IF YOU NO LONGER HOLD OR USE A DEPRECIATING ASSET?

If you cease to hold or use a depreciating asset, a balancing adjustment event may occur. If there is a balancing adjustment event, you need to calculate a balancing adjustment amount to include in your assessable income or to claim as a deduction.

A balancing adjustment event occurs for a depreciating asset when:

- you stop holding it, for example, if the asset is sold, lost or destroyed
- you stop using it and expect never to use it again
- you stop having it installed ready for use and you expect never to install it ready for use
- you have not used it and decide never to use it, or
- a change occurs in the holding or interests in an asset which was or is to become a partnership asset.

A balancing adjustment event does not occur just because a depreciating asset is split or merged; see **Split or merged depreciating assets** on page 22.

However, a balancing adjustment event does occur if you stop holding part of a depreciating asset.

Expenses of a balancing adjustment event (such as advertising or commission expenses) may be included in the second element of the cost of the depreciating asset; see **The cost of a depreciating asset** on page 14.

You work out the balancing adjustment amount by comparing the asset's termination value (such as the proceeds from the sale of an asset) and its adjustable value at the time of the balancing adjustment event; see **Termination value** in the next column.

If the termination value is greater than the adjustable value, you include the excess in your assessable income.

If the termination value is less than the adjustable value, you can deduct the difference.

EXAMPLE: Working out an assessable balancing adjustment amount, ignoring any GST impact

Bridget purchased a cabinet that she held for two years and used wholly for a taxable purpose. She then sold the cabinet for $1,300. Its adjustable value at the time was $1,200.

As the termination value of $1,300 is greater than the adjustable value of the cabinet at the time of its sale, the difference of $100 is included in Bridget's assessable income as an assessable balancing adjustment amount.

EXAMPLE: Working out a deductible balancing adjustment amount, ignoring any GST impact

If Bridget sold the cabinet for $1,000, the termination value would be less than the adjustable value of the cabinet at the time of its sale ($1,200). The difference of $200 is a deductible balancing adjustment amount.

There are situations where these general balancing adjustment rules do not apply:

- If a depreciating asset has been partly used for a non-taxable purpose, the balancing adjustment amount is reduced to reflect only the taxable use. Additionally, a capital gain or capital loss can arise to the extent that the depreciating asset was used for a non-taxable purpose; see **Depreciating asset used for a non-taxable purpose** on page 19.
- Similarly, if the depreciating asset is a leisure facility or a boat and your deductions for the decline in value of the asset have been reduced, the balancing adjustment amount is reduced and a capital gain or capital loss can arise; see **Leisure facilities and boats** on page 20.
- If a depreciating asset is a second-hand depreciating asset in your residential rental property and your deductions for the decline in value of that asset have been reduced, the balancing adjustment amount is reduced to account for the proportion you have not been able to deduct. Additionally, a capital gain or a capital loss can arise; see **Balancing adjustment rules for second-hand depreciating assets in residential rental properties** on page 20 and **Second-hand depreciating assets in residential rental properties** on page 3.
- There are special balancing adjustment rules for cars; see **Balancing adjustment rules for cars** on page 20.
- A balancing adjustment event for a depreciating asset in a low-value or common-rate pool or for which expenditure has been allocated to a software development pool is dealt with under specific rules for those pools; see **Balancing adjustment event for a depreciating asset in a low-value pool** on page 24, **Common-rate pools** on page 25 and **Software development pools** on page 25.
- If the disposal of a depreciating asset is involuntary, you may be able to offset an assessable balancing adjustment amount; see **Involuntary disposal of a depreciating asset** on page 21.
- The assessment of a balancing adjustment amount for an eligible vessel may be deferred for two years where a certificate obtained under the *Shipping Reform (Tax Incentives) Act 2012* applied to that vessel on the day of the balancing adjustment event. Additionally, rollover relief on the deferred amount may be available.
- Rollover relief may apply to the disposal of a depreciating asset in certain circumstances, such as where an asset is transferred between spouses pursuant to a court order following a marriage breakdown; see **Rollover relief** on page 21.
- Rollover relief may also apply to interest realignment arrangements where the taxpayer's original interest in a mining, quarrying or prospecting right was acquired after 1 July 2001; see *Interest realignment arrangements* at **ato.gov.au**
- There are no specific balancing adjustment rules for some primary production depreciating assets (see **Primary production depreciating assets** on page 27) or certain depreciating assets used for landcare operations, electricity connections or phone lines (see **Landcare operations** on page 31 and **Electricity connections and phone lines** on page 32). However, such assets may be considered part of land for capital gains tax (CGT) purposes.

There are special balancing adjustment rules for depreciating assets used in carrying on research and development activities; for more information see *Research and development tax incentive schedule instructions 2020*.

A GST liability will generally occur when a depreciating asset is disposed of by a GST registered entity. For more information, see *GST and the disposal of capital assets* at **ato.gov.au**

Termination value

The termination value is, generally, what you receive or are taken to receive for the asset when a balancing adjustment event occurs. It is made up of amounts you receive and the market value of non-cash benefits (such as goods or services) you receive for the asset.

The most common example of termination value is the proceeds from selling an asset. The termination value may also be an insurance payout for the loss or destruction of a depreciating asset.

The termination value is reduced by the GST payable if the balancing adjustment event is a taxable supply. It can be modified by increasing or decreasing adjustments.

If the termination value is taken to be the market value of the asset (for example, in the case of assets disposed of under a private or domestic arrangement), the market value is reduced by any input tax credit to which you would be entitled had you acquired the asset solely for a creditable purpose.

An amount is not an assessable recoupment if it is included in the termination value of a depreciating asset; see **Recoupment of cost** on page 17.

There are special rules to work out the termination value of depreciating assets in certain circumstances. Some of the more common cases are covered from pages 18–20. If you are not sure of the termination value of a depreciating asset, contact us or your recognised tax adviser.

Non-arm's length and private or domestic arrangements

The termination value of a depreciating asset is its market value just before you stopped holding it where:

- the termination value would otherwise be less than market value and you did not deal at arm's length with another party to the transaction, or
- you stopped holding the asset as a result of a private or domestic arrangement (for instance, you gave the asset to a family member).

Selling a depreciating asset with other property

If you received an amount for the sale of several items that include a depreciating asset, you need to apportion the amount received between the termination value of the depreciating asset and the other items. The termination value is only that part of what you received that is reasonably attributable to the asset.

Apportionment on the basis of the market values of the various items for which the amount is received will be acceptable.

EXAMPLE: Depreciating asset sold with other property, ignoring any GST impact

Ben receives $100,000 for the sale of both a chainsaw (a depreciating asset) and a block of land (not a depreciating asset). It would be reasonable to apportion the $100,000 between:

- the termination value of the chainsaw, and
- the proceeds of sale for the land

based on the relative market values of the chainsaw and the land.

Depreciating asset you stop using or never use

The termination value of a unit of in-house software you still hold but:

- stop using and expect never to use again, or
- decide never to use

is zero. See **In-house software** on page 25.

For any other asset, if you stop using it and expect never to use it again but still hold it, the termination value is the market value when you stop using it. For a depreciating asset you decide never to use but still hold, the termination value is the market value when you make the decision.

Death of the holder

If a person dies and a depreciating asset starts to be held by their legal personal representative (such as the executor of their estate), a balancing adjustment event occurs. The termination value of the asset is its adjustable value on the day the holder died. If they had allocated the asset to a low-value pool, the termination value is the amount of the closing balance of the pool for the income year in which the holder died that is reasonably attributable to the asset; see **Low-value pools** on page 22.

If the asset passes directly to a beneficiary of their estate or to a surviving joint tenant, the termination value is the asset's market value on the day the holder died.

Depreciating asset used for a non-taxable purpose

If a depreciating asset is used both for a taxable purpose and for a non-taxable purpose, the balancing adjustment amount must be reduced by the amount that is attributable to the use for a non-taxable purpose. In addition, a capital gain or capital loss may arise under the capital gain and capital loss provisions. The amount of the capital gain or capital loss is the difference between the asset's cost and its termination value that is attributable to the use for a non-taxable purpose.

For depreciating assets that are used wholly for a non-taxable purpose, the balancing adjustment amount is reduced to zero. The difference between the asset's termination value and its cost can be a capital gain or capital loss.

For some depreciating assets, any capital gain or capital loss arising will be disregarded even though the asset is used for a non-taxable purpose. These assets include:

- cars that are designed to carry a load of less than one tonne and fewer than nine passengers
- motor cycles
- valour or brave conduct decorations awarded
- a collectable (such as a painting or an antique) if the first element of its cost is $500 or less
- assets for which you can deduct an amount for the decline in value as a small business entity under the simplified depreciation rules for the income year in which the balancing adjustment event occurred
- assets acquired before 20 September 1985
- assets used solely to produce exempt income.

In addition, a capital gain arising from the disposal of a personal use asset (an asset used or kept mainly for personal use or enjoyment) of which the first element of cost is $10,000 or less is disregarded for CGT purposes. A capital loss arising from the disposal of any personal use asset is also disregarded for CGT purposes.

EXAMPLE: Depreciating asset used partly for a taxable purpose – balancing adjustment and capital loss

Andrew sells a computer for $600. It was new when he bought it for $1.000. It has been used 40% of the time for private purposes. At the time of its sale, the computer's adjustable value is $700.

Andrew can claim a deduction of $60. This is 60% (the proportion of use for a taxable purpose) of the balancing adjustment amount of $100 (being the difference between the computer's termination value of $600 and its adjustable value of $700 at the time of its sale).

In addition, a capital loss of $160 arises. This is 40% (the proportion of use for a non-taxable purpose) of $400 being the difference between the computer's termination value of $600 and its cost of $1000.

This example ignores any GST impacts.

Leisure facilities and boats

If a balancing adjustment event occurs for a depreciating asset that is a leisure facility or a boat and your deductions for the decline in value of the asset have been reduced (see **Decline in value of leisure facilities** on page 9, and **Decline in value of boats** on page 9) the balancing adjustment amount is reduced to the extent your deductions for decline in value were reduced. In addition, a capital gain or capital loss may arise in respect of the difference between the asset's cost and its termination value that is attributable to the reduction.

These rules are similar to those for working out the balancing adjustment amount for a depreciating asset used for a non-taxable purpose.

Balancing adjustment rules for second-hand depreciating assets in residential rental properties

If a depreciating asset is a second-hand depreciating asset in your residential rental property and your deductions for the decline in value of that asset have been reduced, the balancing adjustment amount must be reduced to account for the proportion you have not been able to deduct. In addition, a capital gain or a capital loss may arise under the capital gain or capital loss provisions.

These rules are similar to those for working out the balancing adjustment amount for a depreciating asset used for a non-taxable purpose.

For more information, see *Rental properties 2020*.

Plant acquired before 21 September 1999 and other depreciating assets acquired before 1 July 2001

Any assessable balancing adjustment amount or capital gain (if the asset was used for a non-taxable purpose) may be reduced if a balancing adjustment event occurs for:

- an item of plant that was acquired before 11.45am AEST on 21 September 1999, or
- a depreciating asset acquired before 1 July 2001 that is not plant.

The amount of the reduction is the cost base of the asset for CGT purposes less its cost. The purpose of this reduction is to preserve CGT cost base advantages for assets acquired before these dates.

One reason that the cost base might exceed the cost is **indexation** of the cost base. There is indexation of the cost base to 30 September 1999 where:

- a CGT event happens to an asset acquired before 11.45am AEST on 21 September 1999, and
- the asset was owned for 12 months or more.

Indexation is not available for assets for which capital gains and capital losses are disregarded; for a list of such assets, see **Depreciating asset used for a non-taxable purpose** on page 19.

However, the balancing adjustment amount is reduced if the asset is:

- a car that is designed to carry a load of less than one tonne and fewer than nine passengers
- a motor cycle
- a valour decoration
- a collectable (such as a painting or an antique) if the first element of its cost is $500 or less
- an asset acquired before 20 September 1985, or
- an asset used solely to produce exempt income.

In these cases, the balancing adjustment amount is reduced by the difference between the asset's termination value and its cost that is attributable to the use of the asset for a taxable purpose.

For more information about indexation of a cost base and the impact of indexation on discount capital gains, see *Guide to capital gains tax 2020*.

Balancing adjustment rules for cars

If a balancing adjustment event occurs for your car, you need to work out any balancing adjustment amount. Special rules apply to the calculation of balancing adjustment amounts for cars.

If a balancing adjustment event occurs for a car you used for a non-taxable purpose, you disregard any capital gain or capital loss.

From 1 July 2015, there are only two methods of calculating work-related car expenses. You may choose the method which in your view, best captures the running costs of your vehicle. The methods are:

- the cents per kilometre method
- the logbook method.

For 2019–20, the cents per kilometre method:

- applies for up to 5,000 business kilometres travelled
- has a rate of 68 cents per kilometre for cars. (We update the rate at the start of each income year.)

If you use the logbook method of claiming car expenses, your balancing adjustment amount needs to be reduced by the amount that is attributable to the use of the car for a non-taxable purpose.

EXAMPLE: Using the logbook method, ignoring any GST impact

> Louise acquired a car on 1 July 2018. During both 2018–19 and 2019–20, Louise used the logbook method to work out her deductions for car expenses. She sold her car for $24,500 on 30 June 2020. At that time, the adjustable value of the car was $18,200.
>
> If Louise's logbook showed that the level of her business use was 40%, her balancing adjustment amount would be $2,520. This is 40% of the difference between the termination value and the adjustable value of the car ($6,300 × 40% = $2,520). Louise must include the amount of $2,520 in her assessable income.

If you have only used the cents per kilometre method of claiming car expenses, no balancing adjustment amount arises. This is because the decline in value of the car is already taken into account as part of the calculation of the car expenses.

However, you may need to include a balancing adjustment amount in your assessable income or claim a deduction in relation to that amount for a balancing adjustment event, which occurs at or after the start of 2019–20 if:

- you switch between the cents per kilometre method and the logbook method of claiming car expenses before 1 July 2019
- you acquired a car before 1 July 2015 and you used the 12% of original value method for claiming car expense deductions for one or more earlier income years.

The above circumstances are only expected to occur in a limited number of cases. If you are affected and you are unsure of how to work out your balancing adjustment amount, contact us or your recognised tax adviser.

For a car subject to the car limit (see **Car limit** on page 16) you need to reduce the termination value. You multiply the termination value by the following fraction:

$$\frac{\text{car limit} \quad + \quad \text{amounts included in the car's second element of cost}}{\text{total cost of the car}}$$

where the total cost of the car is the sum of the first and second elements of cost, ignoring the car limit and after any adjustments for input tax credits; see **GST input tax credits** on page 15. You use the reduced termination value to work out your balancing adjustment amount for the car.

If a car was acquired at a discount and the cost of the car was increased by a discount portion, the termination value of the car must also be increased by that discount portion; see **Car acquired at a discount** on page 16.

If you are a lessee under a luxury car lease or a hirer under a hire purchase agreement and you do not acquire the car when the lease or agreement terminates or ends, you are treated as if you had sold the asset to the lessor or financier, respectively. You will need to work out any assessable or deductible balancing adjustment amount.

Involuntary disposal of a depreciating asset

An involuntary disposal occurs if a depreciating asset is:

- lost or destroyed
- compulsorily acquired by an entity (other than a foreign government agency)
- disposed of to an entity (other than a foreign government agency) after they served a notice on you inviting you to negotiate a sale agreement. They must have informed you that, if negotiations are unsuccessful, the asset will be compulsorily acquired either under an Australian law, other than chapter 6A of the *Corporations Act 2001* or under a foreign law, other than the equivalent of chapter 6A of the *Corporations Act 2001*.
- fixed to land that is disposed of to an entity (other than a foreign government agency) where a mining lease was compulsorily granted over the land and the lease significantly affected (or would have significantly affected) your use of the land, and the entity to which you disposed of the land is the lessee.

You may offset an assessable balancing adjustment amount arising from an involuntary disposal against the cost of one or more replacement assets. If you offset an amount against the cost of a replacement asset for an income year after the one in which the replacement asset's start time occurs, you must also reduce the sum of its opening adjustable value plus any second elements of its cost for that later year.

You must incur the expenditure on the replacement asset, or start to hold it, no earlier than one year before the involuntary disposal and no later than one year after the end of the income year in which that disposal occurred.

The Commissioner can agree to extend the time limit, for example, if it is unlikely that insurance claims for the disposal of the original asset will be settled within the required time even though you have taken all reasonable steps to have the insurance claims settled.

To offset the assessable balancing adjustment amount, the replacement asset must be wholly used, or installed ready for use, by you for a taxable purpose at the end of the income year in which you incurred the expenditure on the asset or you started to hold it, and you must be able to deduct an amount for it.

Rollover relief

If rollover relief is available under UCA, no balancing adjustment amount arises when a balancing adjustment event occurs for a depreciating asset. In some cases, rollover relief is automatic, for example, transfers pursuant to a court order following a marriage breakdown.

In some cases, rollover relief must be chosen. If the event arises from a change in the holding of, or in interests in, a partnership asset such as a variation in the constitution of a partnership or in a partnership interest, the transferor and the transferee must jointly choose the rollover relief.

Rollover relief may be available if you cease to hold a vessel covered by a certificate issued under Part 2 of the *Shipping Reform (Tax Incentives) Act 2012*. If the available relief is chosen, only the balancing adjustment amount that exceeds the cost of acquiring another certified vessel is included in assessable income.

When rollover relief applies, the transferee of the depreciating asset can claim deductions for the asset's decline in value as if there had been no change in holding.

The transferee must use the same method that the transferor used to work out the decline in value of the asset.

If the transferor used the diminishing value method, the transferee must also use the same effective life that the transferor was using.

If the transferor used the prime cost method, the transferee must replace the asset's effective life in the prime cost formula with the asset's remaining effective life, that is, any period of the asset's effective life that is yet to elapse when the transferor stopped holding the asset.

The first element of cost for the transferee is the adjustable value of the asset when it was held by the transferor just before the balancing adjustment event occurred.

There are specific record-keeping requirements for rollover relief; see **Record keeping for rollover relief** on page 39.

The roll-over relief under UCA has been available since 1 July 2007 to small business entities that choose to claim their capital allowance deductions under the simplified depreciation rules; see **Small business entities** on page 36.

Interest realignment arrangements

You may choose to apply rollover relief to interest realignment arrangements where the taxpayer's original interest in the mining, quarrying or prospecting right was acquired after 1 July 2001. An interest realignment arrangement is an arrangement that involves two or more parties that each hold mining, quarrying or prospecting rights that relate to a common development project the parties propose to undertake jointly. The effect of the arrangement must be to align the interests that each party has in each right with their interest in the common development project.

If the available relief is chosen, the effect of the rollover is that a standard balancing adjustment does not occur. The adjustable value of the taxpayer's original right disposed of under the arrangement is transferred to the cost of the new right the same taxpayer received.

Limited recourse debt arrangements

Include excessive deductions for capital allowances as assessable income if expenditure on a depreciating asset is financed or refinanced wholly or partly by limited recourse debt (including a notional loan under certain hire purchase or instalment sale agreements of goods). This will occur where the limited recourse debt terminates but has not been paid in full by the debtor. Because the debt has not been paid in full, the capital allowance deductions allowed for the expenditure exceed the deductions that would be allowable if the unpaid amount of the debt was not counted as capital expenditure of the debtor. Special rules apply to work out whether the debt has been fully paid.

If you are not sure what constitutes a limited recourse debt or how to work out your adjustment to assessable income, contact us or your recognised tax adviser.

Split or merged depreciating assets

If you hold a depreciating asset that is split into two or more assets, or a depreciating asset that is merged into another depreciating asset, you are taken to have stopped holding the original depreciating asset and to have started holding the split or merged asset. However, a balancing adjustment event does not occur just because depreciating assets are split or merged.

For example, removing a CB radio from a truck splits a depreciating asset. If you install the radio in another truck you may be merging the two assets (radio and truck).

After depreciating assets are split or merged, each new asset must satisfy the definition of a depreciating asset if UCA are to apply to it. For each depreciating asset you start to hold, you need to establish the effective life and cost.

The first element of cost for each of the split or merged depreciating assets is:

- a reasonable proportion of the adjustable value of the original asset just before the split or merger, and
- the same proportion of any costs of the split or merger.

If a balancing adjustment event occurs to a merged or split depreciating asset (for example, if it is sold) the balancing adjustment amount is reduced:

- to the extent the asset has been used for a non-taxable purpose
- by any amount of the original depreciating asset that is reasonably attributable to use for a non-taxable purpose of the original depreciating asset before the split or merger.

This reduction is not required if the depreciating asset is mining, quarrying or prospecting rights or information, provided certain activity tests are satisfied.

Foreign currency gains and losses

If you sell a depreciating asset in foreign currency, the termination value of the asset is converted to Australian currency at the exchange rate applicable when you stopped holding the asset. Under the forex provisions, you may make a foreign currency gain or loss if the Australian dollar value of the foreign currency when received differs from the Australian dollar value of the termination value. Any realised foreign currency gain or loss on the transaction is included in assessable income or allowed as a deduction, respectively.

If the TOFA rules apply to you, then the method that you use to calculate your foreign currency gain or loss may differ.

For more information about the TOFA rules, see *Guide to the taxation of financial arrangements (TOFA) rules* in *Taxation of financial arrangements (TOFA)* at **ato.gov.au/tofa**

LOW-VALUE POOLS

UCA adopt most of the former rules for a low-value pool. From 1 July 2001, the decline in value of certain depreciating assets can be worked out through a low-value pool.

Low-value pools established before 1 July 2001 continue and are treated as if they were established under UCA. Use the closing balance of the pool worked out under the former rules to start working out the decline in value of the depreciating assets in the pool under UCA.

Under UCA, you can allocate low-cost assets and low-value assets to a low-value pool.

A **low-cost asset** is a depreciating asset whose cost is less than $1,000 (after GST credits or adjustments) at the end of the income year in which you started to use it, or had it installed ready for use, for a taxable purpose.

A **low-value asset** is a depreciating asset:

- that is not a low-cost asset
- that has an opening adjustable value for the current year of less than $1,000 (worked out using the diminishing value method), and
- for which you used the diminishing value method to work out any deductions for decline in value for a previous income year.

Work out the decline in value of an asset (that you hold jointly with others) on the cost of your interest in the asset. This means that you can allocate your interest in the asset to your low-value pool if the cost of your interest in the asset, or the opening adjustable value of your interest, is less than $1,000. See **Jointly held depreciating assets** on page 15.

You cannot allocate the following depreciating assets to a low-value pool:

- assets for which you used the prime cost method to work out any deductions for decline in value for a previous income year
- horticultural plants
- assets for which you deduct amounts under the simplified depreciation rules; see **Small business entities** on page 36
- assets that cost $300 or less for which you can claim an immediate deduction; see **Immediate deduction for certain non-business depreciating assets (costing $300 or less)** on page 10
- assets that you either use, or have used, in carrying on research and development activities for which you are entitled to a tax offset for a deduction in their decline in value, and your entitlement to that tax offset is worked out under Division 355 of the *Income Tax Assessment Act 1997*
- portable electronic devices[1], computer software, protective clothing, briefcases and tools of trade, if the item was provided to you by your employer, or some or all of the cost of the item was paid for or reimbursed by your employer, and the provision, payment or reimbursement was exempt from fringe benefits tax.

From 1 July 2017, special rules apply to certain second-hand depreciating assets in residential rental premises. For information on how the rules for low-value pools apply to these assets, see *Rental properties 2020*.

Allocating depreciating assets to a low-value pool

You establish a low-value pool the first time you choose to allocate a low-cost or low-value asset to the pool.

When you allocate an asset to the pool, you must make a reasonable estimate of the percentage of your use of the asset that will be for a taxable purpose over its effective life (for a low-cost asset) or the effective life remaining at the start of the income year for which it was allocated to the pool (for a low-value asset). This percentage is known as the asset's 'taxable use percentage'.

It is this taxable use percentage of the cost or opening adjustable value that is written off through the low-value pool.

EXAMPLE: Working out the taxable use percentage

Kate allocates a low-cost asset to a low-value pool. The asset has an effective life of three years. Kate intends to use the asset 90% for taxable purposes in the first year, 80% in the second year and 70% in the third year. A reasonable estimation of the taxable use percentage would be the average of these estimates, that is, 80%.

Once you have allocated an asset to the pool, you cannot vary your estimate of the taxable use percentage even if the actual use of the asset turns out to be different from your estimate.

Once you choose to create a low-value pool and a low-cost asset is allocated to the pool, you must pool all other low-cost assets that you start to hold in that income year and in later income years. However, this rule does not apply to low-value assets. You can decide whether to allocate low-value assets to the pool on an asset-by-asset basis.

Once you have allocated an asset to the pool, it remains in the pool.

Working out the decline in value of depreciating assets in a low-value pool

Once you allocate an asset to a low-value pool, it is not necessary to work out its adjustable value or decline in value separately. Only one annual calculation for the decline in value for all of the depreciating assets in the pool is required.

You work out the deduction for the decline in value of depreciating assets in a low-value pool using a diminishing value rate of 37.5%.

For the income year in which you allocate a low-cost asset to the pool you work out its decline in value at a rate of 18.75% or half the pool rate. Halving the rate recognises that assets may be allocated to the pool throughout the income year. This eliminates the need to make separate calculations for each asset based on the date it was allocated to the pool.

To work out the decline in value of the depreciating assets in a low-value pool, add:

- 18.75% of
  - the taxable use percentage of the cost (first and second elements) of low-cost assets you have allocated to the pool for the income year, and

1 Portable electronic devices include laptops, portable printers, personal digital assistants, calculators, mobile phones and portable GPS navigation receivers.

- the taxable use percentage of any amounts included in the second element of cost for the income year of all assets in the pool at the end of the previous income year, and
- low-value assets allocated to the pool for the income year

and

- 37.5% of
  - the closing pool balance for the previous income year, and
  - the taxable use percentage of the opening adjustable value of any low-value assets allocated to the pool for the income year.

EXAMPLE: Working out the decline in value of depreciating assets in a low-value pool, ignoring any GST impact

During 2019–20, John bought a printer for $990.

As John had allocated low-cost assets to a low-value pool in 2018–19, he had to allocate the printer to the pool because the printer was a low-cost asset. He estimated that he would use the printer 60% for taxable purposes. He therefore allocated 60% of the cost of the printer to the pool, that is, $594.

At the end of 2018–19, John's low-value pool had a closing pool balance of $5,000. In 2019–20, he did not allocate low-cost or low-value assets to the pool other than the printer.

John's deduction for the decline in value of the assets in the pool for 2019–20 is $1,986 worked out as follows:

18.75% of the taxable use percentage of the cost of the printer allocated to the pool during 2019–20 (18.75% × $594)	$111
plus 37.5% of the closing pool balance for 2018–19 (37.5% × $5,000)	$1,875

The **closing balance of a low-value pool** for 2019–20 is:

- the closing pool balance for 2018–19

plus

- the taxable use percentage of the cost (first and second elements) of any low-cost assets allocated to the pool in 2019–20

plus

- the taxable use percentage of the opening adjustable value of low-value assets allocated to the pool in 2019–20

plus

- the taxable use percentage of any amounts included in 2019 in the second element of cost of
  - assets in the pool at the end of 2018–19, and
  - low-value assets allocated in 2019–20

less

- the decline in value of the assets in the pool in 2019–20.

EXAMPLE: Working out the closing balance of a low-value pool, ignoring any GST impact

Following on from the previous example, the closing balance of the pool for 2019–20 is $3,608:

Closing pool balance for 2018–19	$5,000
plus the taxable use percentage of the cost of the printer	$594
less the decline in value of the assets in the pool for 2019–20	($1,986)

Balancing adjustment event for a depreciating asset in a low-value pool

If a balancing adjustment event occurs for a depreciating asset in a low-value pool, you reduce the amount of the closing pool balance for that income year by the taxable use percentage of the asset's termination value. If the taxable use percentage of the asset's termination value exceeds the closing pool balance, you reduce the closing pool balance to zero and include the excess in your assessable income.

A capital gain or capital loss may arise if the asset is not used wholly for a taxable purpose. The difference between the asset's cost and its termination value that is attributable to the estimated use for a non-taxable purpose is treated as a capital gain or capital loss.

EXAMPLE: Disposal of a depreciating asset in a low-value pool, ignoring any GST impact

Following on from the previous examples, during 2020–21 John sells the printer for $500. Because he originally estimated that the printer would only be used 60% for taxable purposes, the closing balance of the pool is reduced by 60% of the termination value of $500, that is, $300.

A capital loss of $196 also arises. As the printer's taxable use percentage is 60%, 40% of the difference between the asset's cost ($990) and its termination value ($500) is treated as a capital loss.

Assuming that John made no additional allocations to or reductions from his low-value pool, the closing balance of the pool for 2020–21 is $1,955:

Closing pool balance for 2019–20	$3,608
less the decline in value of the assets in the pool for the year (37.5% × $3,608)	($1,353)
less the taxable use percentage of the termination value of pooled assets that were disposed of during the year	($300)

This guide includes a worksheet to help you work out your deductions for depreciating assets in a low-value pool.

IN-HOUSE SOFTWARE

In-house software is computer software, or a right (for example, a licence) to use computer software:

- that you acquire or develop (or have another entity develop) that is mainly for your use in performing the functions for which it was developed, and
- for which no amount is deductible outside UCA or the simplified depreciation rules for small business entities.

If expenditure on software is deductible under the ordinary deduction provisions of the income tax law, the software is not in-house software. A deduction for such expenditure is allowable in the income year in which it is incurred.

Expenditure to develop software for exploitation of the copyright is not in-house software. The copyright is intellectual property, which is a depreciating asset, and the decline in value would be calculated using an effective life of 25 years and the prime cost method.

Under UCA, expenditure on in-house software may be deducted using the prime cost method in the following ways.

- The decline in value of acquired in-house software, such as off-the-shelf software, is worked out using an effective life of:
  - four years (if you started to hold the in-house software under a contract entered into after 7.30 PM AEST on 13 May 2008 or otherwise started to hold it after that day), or
  - five years (if the in-house software is first used or first installed ready for use on or after 1 July 2015).
- Expenditure incurred in developing (or having developed) in-house software may be (or may need to be) allocated to a software development pool, on page 25.
- If expenditure incurred in developing (or having another entity develop) in-house software is not allocated to a software development pool, it can be capitalised into the cost of a resulting unit of in-house software. Its decline in value can then be worked out under the prime cost method, from the time the software is first used or first installed ready for use, using an effective life of:
  - four years (if the development started after 7.30 PM AEST on 13 May 2008), or
  - five years (if the in-house software is first used or first installed ready for use on or after 1 July 2015).
- If in-house software costs $300 or less and it is used mainly for producing non-business assessable income, an immediate deduction may be allowable; see **Immediate deduction for certain non-business depreciating assets (costing $300 or less)** on page 10.

The termination value of in-house software that you still hold but stop using and expect never to use again or decide never to use is zero. As a result, you can claim an immediate deduction for the cost of the software at that time.

You can also claim an immediate deduction for expenditure incurred on an in-house software development project (not allocated to a software development pool) if you have not used the software or had it installed ready for use and decide that you will never use it or have it installed ready for use. The amount you can deduct is your total expenditure on the software less any amount you derive for the software or a part of it. Your deduction is limited to the extent that, when you incurred the expenditure, you intended to use the software, or have it installed ready for use, for a taxable purpose.

For information on the deductibility of website expenses, see *TR2016/3 Income tax: deductibility of expenditure on a commercial website.*

Software development pools

The choice of allocating expenditure on developing in-house software to a software development pool was available before 1 July 2001 and continues under UCA.

Under UCA, you can choose to allocate to a software development pool expenditure that you incur on developing (or on having developed) in-house software that you intend to use solely for a taxable purpose. Once you allocate expenditure on such in-house software to a pool, you must allocate all such expenditure incurred in that year or a later year to a software development pool. A different pool is created for each income year in which you incur expenditure on developing (or on having developed) in-house software.

Expenditure on developing in-house software that you do not intend to use solely for a taxable purpose and expenditure on acquiring in-house software cannot be allocated to a software development pool.

If you are entitled to claim a GST input tax credit for expenditure allocated to a software development pool, the expenditure in the pool for the income year in which you are entitled to the credit is reduced by the amount of the credit. Certain adjustments under the GST legislation for expenditure allocated to a software development pool are treated as an outright deduction or income. Other adjustments reduce or increase the amount of the expenditure that has been allocated to the pool for the adjustment year.

You do not get any deduction for expenditure in a software development pool in the income year in which you incur it. For expenditure incurred in an income year starting on or after 1 July 2015, you are allowed deductions at the rate of 30% in each of the next three years and 10% in the year after that.

If you have allocated software development expenditure on a project to a software development pool and the project is abandoned, the expenditure remains to be deducted as part of the pool.

If you have pooled in-house software development expenditure and you receive consideration for the software (for example, insurance proceeds on the destruction of the software), you must include that amount in your assessable income unless you make the choice for rollover relief to apply and do so. Choice of rollover relief is only available in this context where a change occurs in the holding of, or of interests in, the software; see **Rollover relief** on page 21.

You must also include any recoupment of the expenditure in your assessable income.

If the receipt of consideration arises from a non-arm's length dealing and the amount is less than the market value of what the receipt was for, you are taken to receive that market value instead.

COMMON-RATE POOLS

Before 1 July 2001, certain items of plant that had the same depreciation rate and that were used solely for producing assessable income could be allocated to a common-rate pool so that a single calculation of deductions could be made.

You cannot allocate depreciating assets to a common-rate pool under UCA. However, if you have allocated plant to a common-rate pool before 1 July 2001, you can continue to claim deductions under UCA. The pool is treated as a single depreciating asset and the decline in value is worked out using the following rules:

- the diminishing value method must be used
- the opening adjustable value and the cost of the asset on 1 July 2001 is the closing balance of the pool on 30 June 2001
- the effective life component of the diminishing value formula must be replaced with the pool percentage you used before the start of UCA
- in applying the diminishing value formula for the income year in which UCA starts, the base value is the opening adjustable value of the asset, and
- any second elements of the cost of assets in the pool are treated as second elements of the cost of the pool.

If a balancing adjustment event occurs for a depreciating asset in the pool or you stop using an asset wholly for taxable purposes, the asset is removed from the pool. The pool is treated as having been split into the removed asset and the remaining pooled items. The removed asset is then subject to the general rules for working out decline in value or balancing adjustment amounts. The cost of the removed asset and the remaining pool is worked out using the rules for working out the cost of a split asset; see **Split or merged depreciating assets** on page 22.

DEPRECIATING ASSETS AND TAXATION OF FINANCIAL ARRANGEMENTS (TOFA)

The key provisions of the TOFA rules are found in Division 230 of the *Income Tax Assessment Act 1997*.

When do the TOFA rules start to apply to you?

If the TOFA rules apply to you, they apply to the financial arrangements that you start to have from the beginning of your income year commencing on or after 1 July 2010 (unless you elected for the rules to apply a year earlier).

Do the TOFA rules apply to you?

The TOFA rules apply to you if you are:

- an authorised deposit-taking institution, securitisation vehicle or financial sector entity with an aggregated annual turnover of $20 million or more
- a superannuation entity, approved deposit fund, pooled superannuation fund, managed investment scheme or entity with a similar status under foreign law relating to foreign regulation, with assets of $100 million or more
- any other entity (other than an individual) which satisfies one or more of the following
  - an aggregated turnover of $100 million or more
  - assets of $300 million or more
  - financial assets of $100 million or more.

If you do not meet these requirements, you can elect to have the TOFA rules apply to you.

TOFA rules and UCA

The TOFA rules contain interaction provisions which may modify the cost and termination value of a depreciating asset acquired by an entity to which the TOFA rules apply. This will be the case where payment (or a substantial proportion of the payment) is deferred for more than 12 months after delivery of the depreciating asset.

For more information, see:

- **TOFA and the cost of a depreciating asset** below
- **TOFA and the termination value of a depreciating asset** on the next page,
- *Guide to the taxation of financial arrangements (TOFA) rules* at **ato.gov.au/tofa**.

TOFA and the cost of a depreciating asset

If the TOFA rules apply to you and you start or cease to have a financial arrangement (or part of a financial arrangement) as consideration for acquiring a depreciating asset, the TOFA rules will operate to determine the first element of cost. In general the rules mean the first element of cost is the market value of the depreciating asset at the time of acquisition.

In the same way, the TOFA rules can also affect the second element of a depreciating asset's cost when the financial arrangement is consideration for something obtained which is relevant to the second element of cost, for example, capital improvements.

EXAMPLE: TOFA and the cost of a depreciating asset

Aus Co is subject to the TOFA rules.

Aus Co enters into a contract on 1 July 2019 to buy a depreciating asset for $100,000. The depreciating asset is delivered on 1 January 2020 and payment is made on 1 July 2021 (that is, 18 months after delivery). The market value of the depreciating asset on 1 January 2020 is $90,000.

On 1 January 2020 when Aus Co receives the depreciating asset, it starts to have a financial arrangement (the obligation to pay $100,000 in 18 months) which is provided to acquire the depreciating asset.

The TOFA rules mean that Aus Co is taken to have provided an amount equal to the market value of the depreciating asset (worked out at the time it is acquired) for its acquisition. Therefore, Aus Co's first element of cost of the depreciating asset is $90,000.

The financial arrangement is taxed separately under the TOFA rules. The gain or loss worked out under the TOFA rules (loss of $10,000 in this example) does not form part of the first element of cost of the depreciating asset.

The TOFA rules also provide for a hedging tax-timing method that allows gains and losses from certain hedging financial arrangements to be recognised and characterised in accordance with the tax treatment of the underlying item being hedged. For example, if this method applies to a gain or loss on a hedging financial arrangement used to hedge against risks for a depreciating asset, the gain or loss will be assessable or deductible on the same basis as the decline in value deduction.

Note however that the gain or loss on the hedging financial arrangement will not form part of the cost of the depreciating asset.

TOFA and the termination value of a depreciating asset

If the TOFA rules apply to you and you start or cease to have a financial arrangement (or part of a financial arrangement) as consideration for providing a depreciating asset, the TOFA rules will determine the termination value of the depreciating asset. In general the rules mean the termination value is the market value of the depreciating asset at the time of disposal.

EXAMPLE: TOFA and the termination value of a depreciating asset

ABC Co is subject to the TOFA rules.

ABC Co enters into a contract on 1 July 2019 to sell its depreciating asset for $100,000. The depreciating asset is delivered on 1 January 2020 and payment is received on 1 July 2021 (that is, 18 months after delivery). The market value of the depreciating asset on 1 January 2020 is $90,000.

On 1 January 2020 when ABC Co delivers the depreciating asset it will start to have a financial arrangement (the right to receive $100,000 in 18 months which is received for the provision of the depreciating asset).

The TOFA rules mean that ABC Co is taken to have received an amount equal to the market value of the depreciating asset (worked out at the time it is provided) for its disposal. Therefore, ABC Co's termination value for the depreciating asset will be $90,000.

The financial arrangement is taxed separately under the TOFA rules. The gain or loss worked out under the TOFA rules (gain of $10,000 in this example) does not form part of the termination value of the depreciating asset.

The TOFA rules also provide for a hedging tax-timing method that allows gains and losses from certain hedging financial arrangements to be recognised and characterised in accordance with the tax treatment of the underlying item being hedged. For example, if this method applies to a gain or loss on a hedging financial arrangement used to hedge risks for a depreciating asset, the gain will be assessable (or the loss deductible) on the same basis as for the depreciating asset. Therefore, when there is a balancing adjustment event for that depreciating asset, you may have to work out separately:

- the balancing adjustment assessable or deductible amount on the depreciating asset, and
- the assessable or deductible amount for any part of the gain or loss on the hedging financial arrangement under the TOFA rules that has not yet been assessed or deducted.

The gain or loss on the hedging financial arrangement will not form part of the termination value of the depreciating asset.

PRIMARY PRODUCTION DEPRECIATING ASSETS

The general principles of UCA apply to most depreciating assets used in primary production.

However, the decline in value of the following primary production depreciating assets is worked out using special rules:

- facilities used to conserve or convey water
- fencing assets
- fodder storage assets, and
- horticultural plants (including grapevines).

For depreciating assets deductible under these special rules, you cannot use the general rules for working out decline in value or claim the immediate deduction for depreciating assets costing $300 or less (although some are immediately deductible regardless of cost).

Deductions for these assets are not available to a partnership. Costs incurred by a partnership are allocated to each partner who can then claim the relevant deduction for their share of the expenditure.

There are no specific balancing adjustment rules for these depreciating assets. However, the assets may be considered part of the land for CGT purposes.

When the land is disposed of, any deductions you have claimed, or can claim, for the assets may reduce the cost base of the land. For more information, see *Guide to capital gains tax 2020*.

Primary producers may also be able to claim deductions for capital expenditure on landcare operations, electricity connections and phone lines; see **Landcare operations** on page 31 and **Electricity connections and phone lines** on page 32.

Water facilities

A water facility includes plant or a structural improvement that is primarily and principally for the purpose of conserving or conveying water. It also includes an alteration, addition or extension to that plant or structural improvement. Examples of water facilities are dams, tanks, tank stands, bores, wells, irrigation channels, pipes, pumps, water towers and windmills.

The meaning of water facility has been extended to include certain other expenditure incurred on or after 1 July 2004:

- a repair of a capital nature to plant or a structural improvement that is primarily and principally for the purpose of conserving or conveying water (for example, if you purchase a pump that needs substantial work done to it before it can be used in your business, the cost of repairing the pump may be treated as a water facility)
- a structural improvement, or an alteration, addition or extension to a structural improvement, that is reasonably incidental to conserving or conveying water
- a repair of a capital nature to a structural improvement that is reasonably incidental to conserving or conveying water.

Examples of structural improvements that are reasonably incidental to conserving or conveying water are a bridge over an irrigation channel, a culvert (a length of pipe or multiple pipes that are laid under a road to allow the flow of water in a channel to pass under the road) and a fence preventing livestock entering an irrigation channel.

Expenditure incurred on or after 1 July 2004 on a repair of a capital nature, or a change, to a depreciating asset may be eligible for the deduction for water facilities under the extended rules. This is the case even though the pre 1 July 2004 expenditure on the asset itself is not eligible for the deduction under the rules before they were extended. This is because the repair or change to the asset is not treated as part of the asset under the extended rules, and the extended rules are separately applied only to that repair or change.

You can fully deduct capital expenditure on a water facility if you incurred the expenditure at or after 7.30pm (AEST) on 12 May 2015. You fully deduct the expenditure in the income year in which you incurred it. The total deduction cannot be more than the amount of the capital expenditure.

If you incurred the expenditure before this time, the previous UCA continue to apply. These rules allow you to deduct:

- one-third of the expenditure in the income year in which the expenditure is incurred, and
- one-third of the expenditure in each of the following two income years.

Unless you are an irrigation water provider, the expenditure must be incurred by you primarily and principally for conserving or conveying water for use in a primary production business that you conduct on land in Australia. You may claim the deduction even if you are only a lessee of the land. Your deduction is reduced where the water facility is not wholly used for either:

- carrying on a primary production business on land in Australia, or
- a taxable purpose.

The deduction for water facilities was extended to irrigation water providers for expenditure incurred on or after 1 July 2004. An irrigation water provider is an entity whose business is primarily and principally the supply of water to entities for use in primary production businesses on land in Australia. The supply of water by the use of a motor vehicle is excluded.

If you are an irrigation water provider, you must incur the expenditure primarily and principally for the purpose of conserving or conveying water for use in primary production businesses conducted by other entities on land in Australia (being entities supplied with water by you). Your deduction is reduced if the water facility is not used wholly for a taxable purpose.

If the expenditure incurred arises from a non-arm's length dealing and is more than the market value of what the expenditure was for, the amount of the expenditure is taken to be that market value instead.

No deduction is available for capital expenditure incurred on acquiring a second-hand commercial water facility unless you can show that no one else has deducted or could deduct an amount for earlier capital expenditure on the construction, manufacture or previous acquisition of the water facility.

If you are a primary producer and a small business entity, you can choose to work out your deductions for water facilities under either the simplified depreciation rules or these UCA. For more information about the simplified depreciation rules, see **Small business entities** on page 36.

You may need to include a recoupment of expenditure on water facilities in your assessable income. If the expenditure is deductible over more than one income year, special rules apply to determine the amount of any recoupment to be included in assessable income in the year of recoupment and in later income years. An amount received for the sale of a water facility for its market value is not regarded as an assessable recoupment.

Fencing assets

A fencing asset is an asset or structural improvement that is a fence, or a repair of a capital nature, or an alteration, addition or extension, to a fence. The capital expenditure you incur on the construction, manufacture, installation or acquisition of the fencing asset must have been incurred primarily and principally in a primary production business that you conduct on land in Australia. You may claim the deduction even if you are only a lessee of the land.

The term 'fence' takes its ordinary meaning and includes an enclosure or barrier, usually of metal or wood, as around or along a field or paddock. The term 'fence' extends to parts or components of a fence including, but not limited to, posts, rails, wire, droppers, gates, fittings and anchor assemblies.

You can fully deduct capital expenditure on a fencing asset if you incurred the expenditure at or after 7.30pm (AEST) on 12 May 2015. You fully deduct the expenditure in the income year in which you incurred it. The total deduction cannot be more than the amount of the capital expenditure.

If you incurred the expenditure before this time, the previous UCA that allow you to deduct the capital expenditure on a fencing asset over the effective life of the asset continue to apply.

In addition, you cannot deduct an amount for any income year for capital expenditure on a fencing asset if the fencing asset is (or is a repair, alteration, addition or extension to) a stockyard, pen or a portable fence.

Your deduction is reduced in any income year where the fencing asset is not:

- wholly used in carrying on a primary production business on land in Australia, or
- wholly used for a taxable purpose, for example, for the purpose of producing assessable income.

This prevents primary producers from deducting expenditure on a fencing asset to the extent that the asset is used other than in carrying on their primary production business or for a taxable purpose.

If the expenditure incurred arises from a non-arm's length dealing and is more than the market value of what the expenditure was for, the amount of the expenditure is taken to be that market value instead.

If you are a primary producer and a small business entity, you can choose to work out your deductions for fencing assets under either the simplified depreciation rules or these UCA. For more information about the simplified depreciation rules, see **Small business entities** on page 36.

You may need to include a recoupment of expenditure on fencing assets in your assessable income. If the expenditure is deductible over more than one income year, special rules apply to determine the amount of any recoupment to be included in assessable income in the year of recoupment and in later income years. An amount received for the sale of a fencing asset for its market value is not regarded as an assessable recoupment.

Fodder storage assets

A fodder storage asset is an asset that is primarily and principally for the purpose of storing fodder. It is also a structural improvement, or a repair of a capital nature, or an alteration, addition or extension, to an asset or a structural improvement, that is primarily and principally for the purpose of storing fodder.

The capital expenditure you incur on the construction, manufacture, installation or acquisition of the fodder storage asset must have been incurred primarily and principally for use in a primary production business that you conduct on land in Australia. You may claim the deduction even if you are only a lessee of the land.

For a fodder storage asset to satisfy the 'primarily and principally' test, its main purpose (other than some incidental or other minor purpose, but not necessarily the sole purpose) must be to store fodder. For example, if a shed was built for the purpose of storing hay but is occasionally used to store a neighbour's tractor when borrowed twice a year, the shed will be an asset that is primarily and principally for the purpose of storing fodder.

The term 'fodder' takes its ordinary meaning and refers to food for livestock. It is usually dried like grain, hay or silage but can include liquid feed supplements. Examples of typical fodder storage assets include:

- silos
- liquid feed supplement storage tanks
- bins for storing dried grain
- hay sheds
- grain storage sheds, and
- above-ground bunkers for silage.

How you claim deductions for fodder storage assets has changed.

If you incurred a capital expense on a fodder storage asset, you can immediately deduct the cost in the income year you incurred it, if the expense was incurred either:

- on or after 19 August 2018, or
- before 19 August 2018, but the asset was first used or installed ready for use on or after 19 August 2018.

If you already claimed a partial deduction in a previous income year, you will need to amend the previous year's tax return to claim a deduction for the full amount in the year you incurred the expense.

EXAMPLE: Partial deduction already claimed

Peter has a sheep farm. In April 2018, he spent $48,000 on a new hay shed to store fodder for his sheep. The shed wasn't installed ready for use until September 2018.

Peter claimed a $16,000 deduction in his 2018 tax return (one third of the expense). He intended claiming a further $16,000 in his 2020 and 2021 tax returns.

Under the new law, Peter will need to amend his 2018 tax return to claim a deduction in his 2018 tax return for the full cost of the hay shed, with no deductions able to be claimed in any later income years.

If you incurred the capital expenditure after 7.30pm (AEST) on 12 May 2015 but before 19 August 2018, and the asset was first used or installed ready for use before 19 August 2018, you deduct one-third of the expenditure in the income year in which the expenditure is incurred, and the same amount in each of the following two income years. The total deduction over the three income years cannot be more than the amount of the capital expenditure. If you incurred the expenditure before this time, the previous UCA that allow you to deduct the capital expenditure on a fodder storage asset over the effective life of the asset continue to apply.

Your deduction is reduced in any income year where the fodder storage asset is not:

- wholly used in carrying on a primary production business on land in Australia, or
- wholly used for a taxable purpose, for example, for the purpose of producing assessable income.

This prevents primary producers from deducting expenditure on a fodder storage asset to the extent that the asset is used other than in carrying on their primary production business or for a taxable purpose.

No deduction is available for capital expenditure incurred to acquire a second-hand fodder storage asset unless you can show that no one else has deducted or could deduct an amount for earlier capital expenditure on the construction, manufacture or previous acquisition of the fodder storage asset.

If the expenditure incurred arises from a non-arm's length dealing and is more than the market value of what the expenditure was for, the amount of the expenditure is taken to be that market value instead.

If you are a primary producer and a small business entity, you can choose to work out your deductions for fodder storage assets under either the simplified depreciation rules or these UCA. For more information about the simplified depreciation rules, see **Small business entities** on page 36.

You may need to include a recoupment of expenditure on fodder storage assets in your assessable income. If the expenditure is deductible over more than one income year, special rules apply to determine the amount of any recoupment to be included in assessable income in the year of recoupment and in later income years. An amount received for the sale of a fodder storage asset for its market value is not regarded as an assessable recoupment.

Horticultural plants (including grapevines)

A horticultural plant is a live plant or fungus that is cultivated or propagated for any of its products or parts.

You can claim a deduction for the decline in value of horticultural plants, provided:

- you owned the plants (lessees and licensees of land are treated as if they own the horticultural plants on that land)
- you used them in a business of horticulture to produce assessable income, and
- the expense was incurred after 9 May 1995 (or for grapevines, on or after 1 October 2004).

Your deduction for the decline in value of horticultural plants is based on the capital expenditure incurred in establishing the plants. This does not include the cost of purchasing or leasing land, or expenditure in draining swamp or low-lying land or on clearing land. It would include, for example:

- the costs of acquiring and planting seeds, and
- part of the cost of ploughing, contouring, fertilising, stone removal and topsoil enhancement relating to the planting.

You cannot claim this deduction for forestry plants.

If the expenditure incurred arises from a non-arm's length dealing and is more than the market value of what the expenditure was for, the amount of the expenditure is taken to be that market value instead.

The period over which you can deduct the expenditure depends on the effective life of the horticultural plant. You can choose to work out the effective life yourself or you can use the effective life determined by the Commissioner which is listed in Taxation Ruling TR 2019/5.

If the effective life of the plant is less than three years, you can claim the establishment expenditure in full generally in the year in which the first commercial season starts. If the effective life of the plant is three or more years, you can write off the establishment expenditure over the maximum write-off period, which generally begins at the start of what is expected to be the plant's first commercial season. If the plant is destroyed before the end of its effective life, you are allowed a deduction in that year for the remaining unclaimed establishment costs less any proceeds, for example, insurance.

TABLE: Plants with an effective life of three or more years

Effective life	Annual write-off rate	Maximum write-off period
3 to less than 5 years	40%	2 years 183 days
5 to less than 6⅔ years	27%	3 years 257 days
6⅔ to less than 10 years	20%	5 years
10 to less than 13 years	17%	5 years 323 days
13 to less than 30 years	13%	7 years 253 days
30 years or more	7%	14 years 105 days

Where ownership of the horticultural plants changes, the new owner is entitled to continue claiming the balance of capital expenditure they incurred in establishing the plants on the same basis.

If you are a primary producer and a small business entity, you must use UCA to work out your deductions for horticultural plants. For more information about the simplified depreciation rules, see **Small business entities** on page 36.

You may need to include a recoupment of expenditure on horticultural plants in your assessable income. As the expenditure may be deductible over more than one income year, special rules apply to determine the amount of any recoupment to be included in assessable income in the year of recoupment and in later income years. An amount received for the sale of a horticultural plant for its market value is not regarded as an assessable recoupment.

CAPITAL EXPENDITURE DEDUCTIBLE UNDER UCA

UCA maintains the pre 1 July 2001 treatment of some capital expenditure and allows deductions for some capital expenditure that did not previously attract a deduction. Most of these deductions are only available if the expenditure does not form part of the cost of a depreciating asset.

The following types of capital expenditure are deductible under UCA:

- landcare operations incurred by primary producers, other landholders and rural land irrigation water providers; see **Landcare operations** on the next page
- electricity connections or phone lines incurred by primary producers and other landholders; see **Electricity connections and phone lines** on page 32
- environmental protection activities (EPA); see **Environmental protection activities** on page 32
- exploration and prospecting; see **Mining and quarrying, and minerals transport** on page 32
- rehabilitation of mining and quarrying sites; see **Mining and quarrying, and minerals transport** on page 32
- petroleum resource rent tax; see **Mining and quarrying**, **and minerals transport** on page 32
- certain capital expenditure directly connected with a project; see **Project pools** on page 33
- expenditure incurred in establishing trees in a carbon sink forest; see **Carbon sink forests** on page 36
- certain business related costs; see **Business related costs – section 40-880 deductions** on page 35

Generally, to work out your deductions you need to reduce the expenditure by the amount of any GST input tax credits you are entitled to claim for the expenditure. Increasing or decreasing adjustments that relate to the expenditure may be allowed as a deduction or included in assessable income, respectively. Special rules apply to input tax credits on expenditure allocated to a project pool; see **Project pools** on page 33.

Small business entities that have chosen to use the simplified depreciation rules (except primary producers) may deduct capital expenditure under these UCA only if the expenditure is not part of the cost of a depreciating asset. Primary producers that are using the simplified depreciation rules can choose to deduct certain depreciating assets under UCA; see **Small business entities** on page 36.

Landcare operations

You can claim a deduction in the year you incur capital expenditure on a landcare operation for land in Australia.

Unless you are a rural land irrigation water provider, the deduction is available to the extent you use the land for either:

- a primary production business, or
- in the case of rural land, carrying on a business for a taxable purpose from the use of that land, except a business of mining or quarrying.

You may claim the deduction even if you are only a lessee of the land.

The deduction for landcare operations was extended to rural land irrigation water providers for certain expenditure they incur on or after 1 July 2004. A rural land irrigation water provider is an entity whose business is primarily and principally supplying water to entities for use in primary production businesses on land in Australia or businesses (except mining or quarrying businesses) using rural land in Australia. The supply of water by the use of a motor vehicle is excluded.

If you are a rural land irrigation water provider, you can claim a deduction for capital expenditure you incur on a landcare operation for:

- land in Australia that other entities (being entities supplied with water by you) use at the time for carrying on primary production businesses, or
- rural land in Australia that other entities (being entities supplied with water by you) use at the time for carrying on businesses for a taxable purpose from the use of that land (except a business of mining or quarrying).

A rural land irrigation water provider's deduction is reduced by a reasonable amount to reflect an entity's use of the land for a non-taxable purpose after the water provider incurred the expenditure.

A landcare operation is one of the following:

1. erecting fences to separate different land classes in accordance with an approved land management plan
2. erecting fences primarily and principally to keep animals out of areas affected by land degradation to prevent or limit further degradation and to help reclaim the areas
3. constructing a levee or similar improvement
4. constructing drainage works (other than the draining of swamp or low-lying land) primarily and principally to control salinity or assist in drainage control
5. an operation primarily and principally for eradicating or exterminating animal pests from the land
6. an operation primarily and principally for eradicating, exterminating or destroying plant growth detrimental to the land
7. an operation primarily and principally for preventing or combating land degradation other than by erecting fences
8. an extension, alteration or addition to any of the assets described in the first four points above or an extension of an operation described in the fifth to seventh points.

The meaning of landcare operation was extended to apply to expenditure incurred on or after 1 July 2004 on:

- a repair of a capital nature to an asset that is deductible under a landcare operation
- constructing a structural improvement that is reasonably incidental to levees or drainage works deductible under a landcare operation
- a repair of a capital nature, or an alteration, addition or extension, to a structural improvement that is reasonably incidental to levees (or similar improvements) or drainage works deductible under a landcare operation.

An example of a structural improvement that may be reasonably incidental to drainage works is a fence constructed to prevent livestock entering a drain that was constructed to control salinity.

Expenditure incurred on or after 1 July 2004 on a repair of a capital nature, or a change to a depreciating asset may be eligible for the deduction for landcare operations under the extended rules even though the pre 1 July 2004 expenditure on the asset itself is not eligible for the deduction under the rules before they were extended. This is because the repair or change to the asset is not treated as part of the asset under the extended rules, so the extended rules are separately applied to that repair or change.

No deduction is available for landcare operations if the capital expenditure is on plant unless it is on certain fences, dams or other structural improvements. You work out the decline in value of plant not deductible under the landcare provisions using the general rules for working out decline in value; see **Methods of working out decline in value** on page 6.

There are no specific balancing adjustment rules for a depreciating asset on which capital expenditure has been incurred that is deductible under the landcare provisions. That asset may, however, be considered part of the land for CGT purposes.

If a levee is constructed primarily and principally for water conservation, it would be a water facility and no deduction would be allowable under these rules. You would need to work out its decline in value under the rules for water facilities; see **Water facilities** on page 27.

If you are a rural land irrigation water provider and you can deduct expenditure under both the water facilities and landcare operation rules, you can only deduct the expenditure as expenditure on a water facility.

You cannot deduct an amount for landcare operations if any entity can deduct an amount for that expenditure, in any income year, under the carbon sink forest rules; see **Carbon sink forests** on page 36.

If the expenditure incurred arises from a non-arm's length dealing and is more than the market value of what the expenditure was for, the amount of the expenditure is taken to be that market value instead.

A recoupment of the expenditure may be included in your assessable income.

The deduction is not available to a partnership. Costs incurred by a partnership are allocated to each partner who can claim a deduction for their share of the relevant capital expenditure.

Capital expenditure on a landcare operation may be incurred on a depreciating asset. However, if the expenditure is deductible under these rules, you cannot use the general rules for working out decline in value or claim the immediate deduction for certain depreciating assets costing $300 or less.

If you incur the capital expenditure on a depreciating asset and you are a primary producer and a small business entity, you can choose to work out your deductions for these depreciating assets using either the simplified depreciation rules or these UCA. For more information about the simplified depreciation rules, see **Small business entities** on page 36.

Electricity connections and phone lines

You may be able to claim a deduction over 10 years for capital expenditure you incur on:

- connecting mains electricity to land on which a business is carried on for a taxable purpose or upgrading an existing connection to that land, or
- a telephone line on, or extending to, land on which a primary production business is carried on.

If the expenditure incurred arises from a non-arm's length dealing and is more than the market value of what the expenditure was for, the amount of the expenditure is taken to be that market value instead.

A recoupment of the expenditure may be included in your assessable income.

These deductions are not available to a partnership. Costs incurred by a partnership are allocated to each partner who can claim a deduction for their share of the relevant capital expenditure.

Such capital expenditure may be incurred on a depreciating asset. However, if the expenditure is deductible under these rules, you cannot use the general rules for working out decline in value or claim the immediate deduction for depreciating assets costing $300 or less.

If you incur the capital expenditure on a depreciating asset and you are a primary producer and a small business entity, you can choose to work out your deductions for these depreciating assets using either the simplified depreciation rules or these UCA. For more information about the simplified depreciation rules, see **Small business entities** on page 36.

There are no specific balancing adjustment rules for a depreciating asset on which capital expenditure has been incurred that is deductible under these rules. That asset may, however, be considered part of the land for CGT purposes.

Environmental protection activities (EPA)

You can claim an immediate deduction for expenditure that you incur for the sole or dominant purpose of carrying on EPA. EPA are activities undertaken to prevent, fight and remedy pollution, and to treat, clean up, remove and store waste from your earning activity or a site on which another entity carried on a business that you acquired and carry on substantially unchanged as your earning activity. Your earning activity is one you carried on, carry on or propose to carry on for one or more of these purposes:

- producing assessable income (other than a net capital gain)
- exploration or prospecting
- mining site rehabilitation.

You may also claim a deduction for expenditure on EPA relating to a site if the pollution or waste is caused by another entity to which you have leased or granted a right to use the site.

The deduction is not available for:

- EPA bonds and security deposits
- expenditure on acquiring land
- expenditure on constructing or altering buildings, structures or structural improvements
- expenditure to the extent that you can deduct an amount for it under another provision.

Expenditure on EPA that is also for an environmental impact assessment of your project is not deductible as expenditure on EPA. However, if it is capital expenditure directly connected with a project, it could be a project amount for which a deduction would be available over the project life; see **Project pools** on page 33.

Expenditure that forms part of the cost of a depreciating asset is not deductible as expenditure on EPA if a deduction is available for the decline in value of the asset.

A recoupment of the expenditure may be included in your assessable income.

Note that expenditure incurred on or after 19 August 1992 on certain earthworks constructed as a result of carrying out EPA can be written off at a rate of 2.5% under the provisions for capital works expenditure.

Mining and quarrying, and minerals transport

From 1 July 2001, you work out deductions for the decline in value of depreciating assets used in mining and quarrying and in minerals transport using the general rules; see **Working out decline in value** on page 5. The general rules either do not apply or are modified for the depreciating assets or capital expenditure discussed below.

Immediate deduction for depreciating assets used in exploration or prospecting

The decline in value of certain depreciating assets that you first use for exploration or prospecting for minerals (including petroleum), or quarry materials, obtainable by activities carried on for the purpose of producing assessable income, can be its cost. This means you can deduct the cost of the asset in the year in which you start to use it for such activities to the extent that the asset is used for a taxable purpose.

However, where the depreciating asset is a mining, quarrying or prospecting right or mining, quarrying or prospecting information first used for exploration or prospecting for minerals (including petroleum) or quarry materials, an immediate deduction is only available for the asset if one of the following tests are also met:

- The mining, quarrying or prospecting right or mining, quarrying or prospecting information has been acquired from an Australian Government agency or a government entity.
- The mining, quarrying or prospecting information is a geophysical or geological data package you acquired from an entity which predominantly carries on a business of providing mining, quarrying or prospecting information to other entities.
- You created the mining, quarrying or prospecting information or contributed to the cost of its creation.

- You caused the mining, quarrying or prospecting information to be created or contributed to the cost of it being created by an entity which predominantly carries on a business of providing mining, quarrying or prospecting information to other entities.

If one of these tests is not met in respect of the mining, quarrying or prospecting right or mining, quarrying or prospecting information, then there is no immediate deduction of the cost of that asset and the effective life of the asset is the shorter of:

- the effective life provided in the table, if one has been determined (see **Effective life of intangible depreciating assets that are mining, quarrying or prospecting rights, or mining, quarrying or prospecting information** on page 13), and
- 15 years.

Immediate deduction for expenditure which does not form part of the cost of a depreciating asset

An immediate deduction is available for payments of petroleum resource rent tax and for expenditure that does not form part of the cost of a depreciating asset and is incurred on:

- exploration or prospecting for minerals, including petroleum, or quarry materials, obtainable by activities carried on for the purpose of producing assessable income (see *Taxation Ruling TR 2017/1 – Income tax: deductions for mining and petroleum exploration expenditure*), or
- rehabilitation of your mining or quarrying sites.

If the expenditure arises from a non-arm's length dealing and is more than the market value of what the expenditure was for, the amount of the expenditure is taken to be that market value instead.

A recoupment of the expenditure may be included in assessable income.

Farm-in Farm-out arrangements

A farm-in farm-out (FIFO) arrangement broadly involves an exchange of an interest in a mining, quarrying or prospecting right in return for an 'exploration benefit', usually an entitlement to receive exploration services or to have exploration expenditure funded by the other party. The tax treatment of FIFO arrangements, prior to amendments in 2014, is outlined in Miscellaneous Tax Rulings MT 2012/1 and MT 2012/2. Further amendments in 2015 were necessary to ensure that FIFO arrangements did not have certain tax consequences where those consequences could impede genuine exploration activity.

Deduction over time for capital expenditure associated with projects you carry on

Expenditure incurred after 30 June 2001 which does not form part of the cost of a depreciating asset and is not otherwise deductible may be a project amount that you can allocate to a project pool for which deductions are available. To be a project amount, mining capital expenditure or transport capital expenditure must be directly connected with carrying on the mining operations or business, respectively.

Mining capital expenditure is capital expenditure you incur on:

- carrying out eligible mining or quarrying operations
- site preparation for those operations
- necessary buildings and improvements for those operations
- providing or contributing to the cost of providing water, light, power, access or communications to the site of those operations
- buildings used directly for operating or maintaining plant for treating minerals or quarry materials
- buildings and improvements for storing minerals or quarry materials before or after their treatment
- certain housing and welfare (except for quarrying operations).

Transport capital expenditure includes capital expenditure on:

- a railway, road, pipeline, port or other facility used principally for transporting minerals, quarry materials or processed minerals (other than wholly within the site of mining operations) or the transport of petroleum in certain circumstances
- obtaining a right to construct or install such a facility
- compensation for damage or loss caused by constructing or installing such a facility
- earthworks, bridges, tunnels or cuttings necessary for such a facility
- as part of carrying on your business, contributions you make to someone else's expenditure on the above items.

For information on how to work out deductions using a project pool, see **Project pools** below.

Special transitional rules ensure that amounts of undeducted expenditure as at 30 June 2001 incurred under the former special provisions for the mining and quarrying and mineral transport industries remain deductible over the former statutory write-off periods, for example, over the lesser of 10 years or the life of the mine.

Similarly, the former statutory write-off continues to apply to expenditure you incurred after 30 June 2001 if:

- it would have qualified for deduction under the former special provisions

and either:

- it is a cost of a depreciating asset that you started to hold under a contract entered into before 1 July 2001 or otherwise started to hold or began to construct before that day, or
- your expenditure was incurred under a contract entered into before 1 July 2001 and the expenditure does not relate to a depreciating asset.

Eligible exploration or prospecting expenditure incurred after 30 June 2001 that is a cost of a depreciating asset that you started to hold under a contract entered into before 1 July 2001, or otherwise started to hold or began to construct before that day, is deductible at the time it is incurred.

Project pools

Under UCA, you can allocate to a project pool certain capital expenditure incurred after 30 June 2001 that is directly connected with a project you carry on (or propose to carry on) for a taxable purpose, and write it off over the project life. Each project has a separate project pool.

The project must be of sufficient substance and be sufficiently identified that it can be shown that the capital expenditure said to be a 'project amount' is directly connected with the project.

A project is carried on if it involves some form of continuing activity. The holding of a passive investment such as a rental property would not represent sufficient continuing activity to constitute the carrying on of a project.

The capital expenditure is known as a 'project amount' and is expenditure incurred:

- to create or upgrade community infrastructure for a community associated with the project; this expenditure must be paid (not just incurred) to be a project amount
- for site preparation costs for depreciating assets (other than draining swamp or low-lying land, or clearing land for horticultural plants)
- for feasibility studies or environmental assessments for the project
- to obtain information associated with the project
- in seeking to obtain a right to intellectual property
- for ornamental trees or shrubs.

Mining capital expenditure and transport capital expenditure (see **Mining and quarrying, and minerals transport** on page 32) can also be a project amount that you can allocate to a project pool and for which you can claim a deduction.

The expenditure must not be otherwise deductible or form part of the cost of a depreciating asset held by you.

If the expenditure incurred arises from a non-arm's length dealing and is more than the market value of what the expenditure was for, the amount of the expenditure is taken to be that market value instead.

The deduction for project amounts allocated to a project pool begins when the project starts to operate. For projects that start on or after 10 May 2006 and that only contain project amounts incurred on or after 10 May 2006 the calculation is:

$$\frac{\text{pool value} \times 200\%}{\text{DV project pool life}}$$

For projects that started before 10 May 2006 the calculation is:

$$\frac{\text{pool value} \times 150\%}{\text{DV project pool life}}$$

The 'DV project pool life' is the project life of a project or the most recently recalculated project life of a project.

Certain projects may be taken to have started to operate before 10 May 2006 (for example, when a project is abandoned and restarted on or after 10 May 2006 so that deductions can be calculated using the post 9 May 2006 formula).

The **pool value** for an income year is, broadly, the sum of the project amounts allocated to the pool up to the end of that year less the sum of the deductions you have claimed for the pool in previous years (or could have claimed had the project operated wholly for a taxable purpose).

The pool value can be subject to adjustments.

If you are entitled to claim a GST input tax credit for expenditure allocated to a project pool, you reduce the pool value in the income year in which you are, or become, entitled to the credit by the amount of the credit. Certain increasing or decreasing adjustments for expenditure allocated to a project pool may also affect the pool value.

If during any income year commencing after 30 June 2003 you met or otherwise ceased to have an obligation to pay foreign currency incurred as a project amount allocated to a project pool, a foreign currency gain or loss (referred to as a forex realisation gain or loss) may have arisen under the forex provisions. If the project amount was incurred after 30 June 2003 (or earlier, if you so elected) and became due for payment within 12 months after you incurred it, then the pool value for the income year you incurred the project amount is adjusted by the amount of any forex realisation gain or loss. This is known as 'the 12-month rule'. You are able to elect out of the 12-month rule in limited circumstances (for more information, see *Forex: election out of the 12 month rule* at **ato.gov.au**).

If you have elected out of the 12-month rule, the pool value is not adjusted; instead, any forex realisation loss is generally deductible and any gain is included in assessable income.

DV project pool life: You must estimate the project life of your project each year. The project life may not change, but reconsider the question each year. If your new estimate is different from the previous estimate, the DV project pool life you use in the formula is that new estimated project life, not the project life estimated the previous year.

The **project life** is worked out by estimating how long (in years and fractions of years) it will be from when the project starts to operate until it stops operating. Factors that are personal only to you, such as how long you intend to carry on the project, are not relevant when objectively estimating project life. Factors outside your control, such as something inherent in the project itself, for example, a legislative or environmental restriction limiting the period of operation, would be relevant.

If there is no finite project life, there is no project and therefore no deduction is available under these rules.

There is no need to apportion the deduction if the project starts to operate during the income year, or for project amounts incurred during the income year.

You reduce the deduction to the extent to which you operate the project for a non-taxable purpose during the income year.

If the project is abandoned, sold or otherwise disposed of in the income year, you can deduct the sum of the closing pool value of the prior income year plus any project amounts allocated to the pool during the income year, after allowing for any necessary pool value adjustments (see the previous page). A project is abandoned if it stops operating and will not operate again.

Your assessable income will include any amount received for the abandonment, sale or other disposal of a project.

If you recoup an amount of expenditure allocated to a project pool or if you derive a capital amount for a project amount or something on which a project amount was expended, you must include the amount in assessable income.

If any receipt arises from a non-arm's length dealing and the amount is less than the market value of what the receipt was for, you are taken to have received that market value instead.

Business related costs – section 40-880 deductions

UCA allows a five-year write-off for certain business related capital expenditure, provided that no other provision either takes the expenditure into account or denies a deduction (known as blackhole expenditure).

Expenditure incurred after 30 June 2005 is deductible if you incur it:

- for your business
- for a business that used to be carried on, such as capital expenses incurred in order to cease the business
- for a business proposed to be carried on, such as the costs of feasibility studies, market research or setting up the business entity
- as a shareholder, beneficiary or partner to liquidate or deregister a company or to wind up a trust or partnership (and the company, trust or partnership must have carried on a business).

If you incur expenditure for your existing business, a business that you used to carry on or a business that you propose to carry on, the expenditure is deductible to the extent the business is, was or is proposed to be carried on for a taxable purpose.

You cannot deduct expenditure for an existing business that is carried on by another entity. However, you can deduct expenditure you incur for a business that used to be, or is proposed to be, carried on by another entity. The expenditure is only deductible to the extent that:

- the business was, or is proposed to be, carried on for a taxable purpose, and
- the expenditure is in connection with your deriving assessable income from the business and the business that was carried on or is proposed to be carried on.

A five-year straight-line write-off is allowed for certain capital expenditure incurred to terminate a lease or licence if the expenditure is incurred in the course of carrying on a business, or in connection with ceasing to carry on a business. See *Blackhole expenditure: business related expenses,* at **ato.gov.au**

If you are an individual operating either alone or in partnership, this deduction may be affected by the non-commercial loss rules; see *Guide to non-commercial losses,* at **ato.gov.au**

EXAMPLE

Ralph decides to carry on his existing business through a company. He will continue to carry on the business for a taxable purpose. He will be the only shareholder of the company and he will be entitled to receive all the profits from the business.

Ralph incurs expenses to incorporate the existing business. Legally, he and the company are separate entities. However, Ralph can deduct the incorporation expenses (subject to non-commercial loss rules). This is because the expenditure is for the business to be carried on by the company and the expenditure is in connection with his deriving assessable income from the business.

The extent to which a business is, was or is proposed to be carried on for a taxable purpose is worked out at the time the expenditure is incurred. For an existing business or a business proposed to be carried on, you need to take into account all known and predictable facts in all years.

For a business to be 'proposed to be' carried on, you need to be able to sufficiently identify the business and there needs to be a commitment of some substance to commence the business. Examples of such a commitment are establishing business premises, investment in capital assets and development of a business plan. The commitment must be evident at the time the expenditure is incurred. It must also be reasonable to conclude that the business is proposed to be carried on within a reasonable time. This time may vary according to the industry or the nature of the business.

The deduction cannot be claimed for capital expenditure to the extent to which it:

- can be deducted under another provision
- forms part of the cost of a depreciating asset you hold, used to hold or will hold
- forms part of the cost of land
- relates to a lease or other legal or equitable right
- would be taken into account in working out an assessable profit or deductible loss
- could be taken into account in working out a capital gain or a capital loss
- would be specifically not deductible under the income tax laws if the expenditure was not capital expenditure
- is specifically not deductible under the income tax laws for a reason other than the expenditure is capital expenditure
- is of a private or domestic nature
- is incurred for gaining or producing exempt income or non-assessable non-exempt income
- is excluded from the cost or cost base of an asset because, under special rules in UCA or the CGT regimes respectively, the cost or cost base of the asset was taken to be the market value
- is a return of, or on, capital (for example, dividends paid by companies or distributions by trustees) or a return of a non-assessable amount (for example, repayments of loan principal).

If the expenditure:

- arises from a non-arm's length dealing, and
- is more than the market value of what the expenditure was for

then the amount of the expenditure is taken to be that market value instead.

You deduct 20% of the expenditure in the year you incur it and in each of the following four years.

From 2015–16, certain start-up expenditure for a small business that would be deductible over five years is fully deductible in the income year in which the expenditure is incurred; see **Certain start-up expenses immediately deductible** on page 37.

Even if the business ceases or the proposed business does not commence (for example, if there is an unforeseen change in circumstances) the deduction may be able to be claimed over the five years. Deductions for expenditure for a proposed business can be claimed before the business is carried on. However, if you are an individual taxpayer, the non-commercial loss rules may defer your deductions for pre-and post-business expenditure; see *Guide to non-commercial losses,* at **ato.gov.au**

A recoupment of the expenditure may be included in your assessable income.

Carbon sink forests

You can claim a deduction, subject to certain conditions, for the expenditure you incur in establishing trees in a carbon sink forest.

- For such trees established in 2007–08, 2008–09, 2009–10, 2010–11 or 2011–12, you can claim an immediate deduction for the expenditure you incurred in establishing the trees.
- For such trees established in 2012–13 or later, you can claim a maximum capital write-off rate of 7% of the expenditure incurred in establishing the trees (conditions apply).

You will find the rules in Subdivision 40-J of the *Income Tax Assessment Act 1997* and further information at **ato.gov.au**

SMALL BUSINESS ENTITIES

Eligibility

You are eligible to be a small business entity for an income year if:

- you carry on a business in that year, and
- you have an aggregated turnover of less than $10 million.

Similarly to the previous grouping rules that existed under the former simplified tax system, the new aggregation rules use the concepts of ‘connected with’ (which is based on control) and ‘affiliates’ to determine whether the turnover of any related businesses need to be included in the aggregated turnover of your business.

It is not necessary to specifically elect to be an eligible small business each year in order to access the concessions. However, you must assess your eligibility for the concessions each year. For more information, see *Eligibility as a small business entity*, at **ato.gov.au**

Instant asset write-off

There have been changes to the instant asset write-off threshold.

The threshold for assets that were first acquired at or after 7.30pm AEST on 12 May 2015 is:

$20,000 if they were first used or installed ready for use from 7.30pm (AEST) on 12 May 2015 until 28 January 2019

$25,000 if they were first used or installed ready for use from 29 January 2019 until before 7.30pm (AEDT) on 2 April 2019

$30,000 if they were first used or installed ready for use from 7.30pm (AEDT) on 2 April 2019 until 11 March 2020

$150,000 if they were first used or installed ready for use from 12 March 2020 to 30 June 2020

The car limit applies to the limit the instant asset write off deduction where a car is designed to mainly carry passengers.

For more information, see *Small business entity concessions*, at **ato.gov.au**

Simplified depreciation rules

If you are an eligible small business, you may choose to calculate deductions for your depreciating assets using these rules.

In general, the taxable purpose proportions of the adjustable values and second element of cost amounts of most:

- depreciating assets costing less than the relevant instant asset write-off threshold are written off immediately
- other depreciating assets are pooled in a general small business pool and deducted at the rate of 30%
- newly acquired assets are deducted at 15% (half the pool rate) in the first year, regardless of when they were acquired during the year. However, if the new asset is eligible for the Backing business investment incentive then, in the first year it is added to the pool, it has an accelerated rate of 57.5%. For more information, go to **ato.gov.au** and search for 'Backing business investment'.

The threshold at which a small business writes off the total balance of the general small business pool is aligned with the relevant instant write-off threshold, which is $150,000 for 30 June 2020.

The taxable purpose proportion is your reasonable estimate of the proportion you will use, or have installed ready for use, of a particular depreciating asset for a taxable purpose.

If you are eligible, and choose to continue to use the simplified depreciation rules, you will continue to include any new depreciating assets in the relevant pool. If you choose not to use the simplified depreciation rules you cannot add any new assets to those pools. You can alternatively account for those assets under UCA; see *Small business entity concessions* at **ato.gov.au**

Rollover relief

As part of the Small business tax concessions, you may be able to defer any gain or loss resulting from a transfer of a depreciating asset between entities with the same economic ownership under the Small business restructure roll-over concessions, which apply from 1 July 2016.

Modifications, under the Commissioner's remedial power, may apply to the asset disposal to prevent unintended taxation consequences where:

- a transfer takes place on or after 8 May 2018, and
- the asset transferred satisfies conditions under a small business restructure roll-over.

For more information, see:

- *Small business restructure rollover*, at **ato.gov.au**
- CRP 2017/2 *Taxation Administration (Remedial Power - Small Business Restructure Roll-over) Determination 2017*, at **ato.gov.au**

CERTAIN START-UP EXPENSES IMMEDIATELY DEDUCTIBLE

From the 2015–16 income year, certain start-up expenditure that would be deductible over five years under section 40-880 of the ITAA 1997 is fully deductible in the income year in which the expenditure is incurred.

Expenditure may be fully deductible in the income year incurred if:

- it relates to a small business that is proposed to be carried on

and

- it is incurred
  - in obtaining advice or services relating to the proposed structure or the proposed operation of the business, or
  - in payment to an Australian government agency of a fee, tax or charge relating to setting up the business or establishing its operating structure

  and
- in that income year in which the deduction is claimed, the entity that incurred the expenditure
  - is a small business entity, or
  - does not carry on a business and does not control or is controlled by an entity carrying on a business in that income year that is not a small business entity in that income year.

Professional advice and services relating to the structure or the operations of the proposed business

Professional advice and services that may be deductible under this section include advice from a lawyer or accountant on how the business may be best structured as well as services such individuals or firms may provide in setting up legal arrangements or business systems for such structures. It does not include the cost of acquiring assets that may be used by the business. Similarly, advice and services in relation to the operation of the proposed business includes professional advice on the viability of the proposed business (including due diligence where an existing business is being purchased) and the development of a business plan.

Payments to Australian government agencies

Payments of taxes, fees or charges relating to establishing the business or its structure to an Australian government agency may be immediately deducted under this section.

An Australian government agency is a Commonwealth, State or Territory government (or an authority of these). Local governments are included as an authority of the relevant State or Territory government.

Broadly, this category of expenditure includes regulatory costs incurred in setting up the new business. Examples include the costs associated with creating the entity that may operate the business (such as the fee for creating a company) and costs associated with transferring assets to the entity which is intended to carry on the proposed business (for example, the payment of stamp duty). It does not include expenditure relating to taxes of general application such as income tax. The payment of these general taxes does not relate to establishing a business or its structure but instead to the operation and activities of the businesses. Such general taxes are also not normally deductible under section 40-880.

Eligible taxpayers

Immediate deductibility is also limited to expenditure by certain entities, with the effect of excluding expenditure incurred by larger businesses.

If the claimant entity carries on a business in the income year, it must itself be a small business entity which is broadly defined under tax law as an entity with an aggregate annual turnover of less than $10 million.

Alternatively, if this entity does not carry on a business in the income year it must not be connected with or be an affiliate an entity that carries on a business in the income year that is not a small business entity.

EXAMPLE: Start-up expense which can be immediately deducted

Winston Co is a company that is a small business entity and is in the process of setting up a florist business, to be operated by a separate entity. Winston Co is uncertain as to the best location for the proposed business. Winston Co obtains advice from a consultant in order to assist in determining a suitable location. These amendments will apply to the cost of obtaining this advice, allowing it to be fully deducted in the income year in which it is incurred.

EXAMPLE: Capital expenditure which cannot be immediately deducted

Percy already carries on an established small landscaping business. As part of plans to expand and improve his business Percy obtains financial advice about financing the expansion. As Percy's business is already established the subsection 40-880(2A) of the ITAA 1997 deductions will not apply.

Assets for which deductions are claimed under UCA

For some depreciating assets, deductions must be claimed under UCA rather than under the simplified depreciation rules:

- assets allocated to a low-value or a common-rate pool before you started to use the simplified depreciation rules (those assets must remain in the pool and deductions must be claimed under UCA)
- horticultural plants
- in-house software where the development expenditure is allocated to a software development pool; see **Software development pools** on page 25, and
- assets that are leased out, or are expected to be leased out, for more than 50% of the time on a depreciating asset lease. (This does not apply to depreciating assets subject to hire purchase agreements, or short-term hire agreements on an intermittent hourly, daily, weekly or monthly basis where there is no substantial continuity of hiring.)

Depreciating assets used in rental properties are generally excluded from the simplified depreciation rules on the basis that they are subject to a depreciating asset lease.

You cannot deduct an amount for a decline in value of second-hand depreciating asset in a residential rental property under the simplified depreciation rules if the amount is not deductible under UCA.

Capital expenditure deductible under UCA

As the simplified depreciation rules apply only to depreciating assets, certain capital expenditure incurred by a small business entity that does not form part of the cost of a depreciating asset may be deducted under UCA for deducting capital expenditure.

This includes capital expenditure on certain business related costs and amounts directly connected with a project; see **Capital expenditure deductible under UCA** on page 30.

In-house software

Under UCA, you can choose to allocate to a software development pool expenditure you incur in developing (or having another entity develop) in-house software you intend to use solely for a taxable purpose. Once you allocate expenditure on such software to a pool, you must allocate all such expenditure incurred thereafter (in that year or in a later year) to a pool; see **Software development pools** on page 25.

If you have allocated such expenditure to a software development pool either before or since using the simplified depreciation rules, you must continue to allocate such expenditure to a software development pool and calculate your deductions under UCA.

If you:

- have not previously allocated such expenditure to a software development pool and you choose not to do so this year, or
- incur the expenditure in developing in-house software that you do not intend using solely for a taxable purpose

then you can capitalise it into the cost of the unit of software developed and claim deductions for the unit of in-house software under the simplified depreciation rules when you start to use it (or install it ready for use) for a taxable purpose. Its decline in value can then be worked out using an effective life of:

- four years (if you started to hold the in-house software under a contract entered into after 7.30 PM AEST on 13 May 2008 or otherwise started to hold it after that day) or
- five years (if the in-house software is first used or first installed ready for use on or after 1 July 2015)

and using the prime cost method.

Deductions for in-house software acquired off the shelf by a small business entity for use in their business are available under the simplified depreciation rules. For example, such an item costing less than $1,000 will qualify for an outright deduction.

For information on the deductibility of website expenses, see *Taxation Ruling TR 2016/2 Income tax: deductibility of expenditure on a commercial website*.

Primary producers

A small business entity can choose to claim deductions under either the simplified depreciation rules or UCA for certain depreciating assets used in the course of carrying on a business of primary production. The choice is available for:

- **water facilities** on page 27
- **fencing assets** on page 28
- **fodder storage assets** on page 29
- depreciating assets relating to
  - **landcare operations** on page 31
  - **electricity connections and phone lines** on page 32.

You can choose to claim your deductions under the simplified depreciation rules or UCA for each depreciating asset. Once you have made the choice, it cannot be changed.

RECORD KEEPING

You must keep the following information for a depreciating asset:

- the first and second elements of cost
- the opening adjustable value for 2019–20
- any adjustments made to cost or adjustable value
- the date you started holding the asset and its start time
- the rate or effective life used to work out the decline in value
- the method used to work out the decline in value
- the amount of your deduction for the decline in value and any reduction for use of the asset for a non-taxable purpose
- the closing adjustable value for 2019–20
- any recoupment of cost you have included in assessable income, and
- if a balancing adjustment event occurred for the asset in 2019–20
  - the date of the balancing adjustment event
  - the termination value
  - the adjustable value on the date of the balancing adjustment event
  - the balancing adjustment amount
  - any reduction of the balancing adjustment amount, and
  - details of any rollover or balancing adjustment relief.

You must also keep:

- details of how you worked out the effective life of a depreciating asset where you have not adopted the effective life determined by the Commissioner
- if you have recalculated the effective life of an asset
  - the date of the recalculation
  - the recalculated effective life
  - the reason for the recalculation, and
  - details of how you worked out the recalculated effective life
- original documents such as suppliers' invoices and receipts for expenditure on the depreciating asset.

You must keep additional records if:

- you acquire an asset from an associate, or
- you acquire a depreciating asset and
  - the new user is the same as the former user, or
  - the new user is an associate of the former user.
- See **Depreciating asset acquired from an associate** and **Sale and leaseback arrangements**, both on page 9.

Failure to keep proper records will attract penalties.

Record keeping for low-value pools

For depreciating assets in a low-value pool, you need to keep the following details (some details relate to the asset and some to the pool):

- the date you started holding the asset
- the date the asset started in the low-value pool and the date you started holding them
- the closing low-value pool balance at the end of 2018–19
- any second element of cost you incurred in 2019–20 for assets in the pool at the end of 2018–19
- the opening adjustable value of any low-value asset you allocated to the pool in 2019–20
- the first element of cost of any low-cost asset you allocated to the low-value pool in 2019–20
- the second element of cost of low-cost assets and low-value assets you allocated to the low value pool in 2019–20
- the taxable use percentage of each amount added to the pool in 2019–20
- the termination value and the taxable use percentage for assets in the pool for which a balancing adjustment event occurred in 2019–20
- the income year and the date of the balancing adjustment event
- the closing pool balance
- the decline in value
- any amount included in assessable income because the taxable use percentage of the termination value exceeds the closing pool balance, and
- any recoupment of cost you have included in assessable income.

A capital gain or capital loss may arise when a balancing adjustment event occurs either:

- for a depreciating asset which you expect to use for a non-taxable purpose
- for a depreciating asset which you have allocated to a low-value pool and expect to use for a non-taxable purpose.

If either of the above occurs, you must keep the following information:

- the first and second elements of cost
- the termination value
- the taxable use percentage.

Keep records about a depreciating asset allocated to a low-value pool for five years, starting from the end of the income year in which the asset was allocated to the pool.

There are two exceptions:

- If an amount is included in the second element of an asset's cost after the asset is allocated to a low-value pool, keep the records of the cost for a period of five years from the time you incurred the expenditure.
- Keep records of acquisitions relating to delayed claims for GST input tax credits for at least five years after lodgment. If a claim for input tax credits relates to a depreciating asset in a low-value pool, keep the record of acquisition for five years from a date which begins later than the end of the income year in which the asset was allocated to the pool.

Record keeping for rollover relief

If automatic rollover relief applies (see **Rollover relief** on page 21) the transferor must give the transferee a notice:

- containing enough information for the transferee to work out how UCA apply to the transferee's holding of the depreciating asset
- within six months after the end of the transferee's income year in which the balancing adjustment event occurred.

The transferee must keep a copy of the notice for five years after the asset is:

- disposed of
- lost, or
- destroyed.

If a transferor and transferee jointly choose rollover relief, the decision:

- must be in writing, and

- must contain enough information for the transferee to work out how UCA apply to the transferee's holding of the depreciating asset
- must be made within six months after the end of the transferee's income year in which the balancing adjustment event occurred.

The transferor must keep a copy of the agreement for five years after the balancing adjustment event occurred.

The transferee must keep a copy of the agreement for five years after the next balancing adjustment event that occurred for the asset.

DEFINITIONS

The most commonly used UCA terms are explained here.

The table below provides a comparison of some of the UCA terms with those used in the former depreciation rules.

Former depreciation rules	UCA
Plant	Depreciating asset
Own	Hold
Cost	First and second elements of cost
Luxury car limit	Car limit
Income-producing use	Taxable purpose
Depreciation	Decline in value
Undeducted cost	Adjustable value

Adjustable value: A depreciating asset's adjustable value at a particular time is its cost (first and second elements) less any decline in value up to that time.

The opening adjustable value of an asset for an income year is generally the same as its adjustable value at the end of the previous income year.

Balancing adjustment amount: The balancing adjustment amount is the difference between the termination value and the adjustable value of a depreciating asset at the time of a balancing adjustment event.

If an asset's termination value is greater than its adjustable value, the difference is generally an assessable balancing adjustment amount.

If the termination value is less than the adjustable value, the difference is generally a deductible balancing adjustment amount.

Balancing adjustment event: Generally, a balancing adjustment event occurs for a depreciating asset if you stop holding it (for example, if you sell it) or you stop using it and you expect never to use it again.

Car limit: If the first element of cost of a car exceeds the car limit for the financial year in which you start to hold it, that first element of cost is generally reduced to the car limit. The car limit for 2019–20 is $57,581.

Days held: Days held is the number of days you held the asset in the income year in which you used it or had it installed ready for use for any purpose.

Decline in value: Deductions for the cost of a depreciating asset are based on the decline in value.

For most depreciating assets, you have the choice of two methods to work out the decline in value of a depreciating asset: the prime cost method or the diminishing value method; see **Methods of working out decline in value** on page 6.

Depreciating asset: A depreciating asset is an asset that has a limited effective life and can reasonably be expected to decline in value over the time it is used.

Some assets are specifically excluded from the definition of depreciating asset; see **What is a depreciating asset?** on page 3.

Effective life: Generally, the effective life of a depreciating asset is how long it can be used by any entity for a taxable purpose or for the purpose of producing exempt income or non-assessable non-exempt income:

- having regard to the wear and tear from your expected circumstances of use
- assuming it will be maintained in reasonably good order and condition, and
- having regard to the period within which it is likely to be scrapped, sold for no more than scrap value or abandoned.

First element of cost: The first element of cost is, broadly, the amount paid (money or the market value of property given) or the amount taken to have been paid to hold the asset. It also includes amounts incurred after 30 June 2005 that are taken to have been paid for starting to hold the asset. The amounts must be directly connected with holding the asset.

Holder: Only a holder of a depreciating asset may deduct an amount for its decline in value. In most cases, the legal owner of a depreciating asset will be its holder; see **Who can claim deductions for the decline in value of a depreciating asset?** on page 4.

Indexation: Indexation is a methodology used in calculating a cost for capital gains tax for depreciating assets acquired before 21 September 1999 that have been used partly for a private purpose.

Second element of cost: The second element of cost is, broadly, the amount paid (money or the market value of property given) or the amount taken to have been paid to bring the asset to its present condition and location at any time, such as the cost incurred to improve the asset. It also includes expenses incurred after 30 June 2005 on a balancing adjustment event occurring for the asset, such as advertising or commission expenses.

Start time: A depreciating asset's start time is generally when you first use it (or install it ready for use) for any purpose, including a private purpose.

Taxable purpose: A taxable purpose is the purpose of producing assessable income, the purpose of exploration or prospecting, the purpose of mining site rehabilitation, or environmental protection activities.

Termination value: Generally, the termination value is what you receive or are taken to receive for an asset as a result of a balancing adjustment event. For example, the proceeds from selling an asset would be the asset's termination value.

GUIDELINES FOR USING THE DEPRECIATING ASSETS WORKSHEET

The depreciating assets worksheet is on page 43.

Primary production only and **Non-primary production only:** Use a separate worksheet for each category.

Cost: The cost of a depreciating asset includes the first and second elements of cost. You must adjust the cost of an asset in certain circumstances, such as when the first element of a car's cost exceeds the car limit. If you have adjusted the cost of the asset, include the adjusted cost in this column; see **The cost of a depreciating asset** on page 14.

Opening adjustable value and **Adjustable value at end of year:** The adjustable value of a depreciating asset at any time is its cost reduced by any decline in value up to that time. The opening adjustable value of an asset for an income year is generally the same as its adjustable value at the end of the previous income year.

Balancing adjustment events: Generally, a balancing adjustment event occurs for a depreciating asset when you stop holding it (for example, if you sell it) or when you stop using it and you expect never to use it again; see **What happens if you no longer hold or use a depreciating asset?** on page 17.

Termination value: Generally, the termination value is what you receive or are taken to have received for the asset as a result of a balancing adjustment event, such as the proceeds from selling the asset; see **Termination value** on page 18.

Balancing adjustment amounts: If the asset's termination value is greater than its adjustable value, the excess is generally an assessable balancing adjustment amount. If the termination value is less than the adjustable value, the difference is a deductible balancing adjustment amount. If you use the asset for a non-taxable purpose, you reduce the balancing adjustment amount and a capital gain or capital loss may arise; see **Depreciating asset used for a non-taxable purpose** on page 19.

Balancing adjustment relief: This refers to the offsetting of otherwise assessable balancing adjustment amounts for involuntary disposals (see **Involuntary disposal of a depreciating asset** on page 21) or when rollover relief applies; see **Rollover relief** on page 21.

Decline in value: There are two methods of working out the decline in value of a depreciating asset; prime cost and diminishing value; see **Methods of working out decline in value** on page 6.

Effective life and **Percentage rate:** Both the prime cost and diminishing value methods are based on a depreciating asset's effective life; see **Effective life of depreciating assets** on page 12. However, if you are able to use accelerated rates of depreciation (see **Accelerated depreciation** on page 8) you use the relevant percentage rate to work out the decline in value rather than the effective life.

A list of accelerated rates is provided; see **Accelerated rates of depreciation** below.

Taxable use percentage: This is the proportion of your use of a particular depreciating asset for a taxable purpose.

Deduction for decline in value: Your deduction for the decline in value of the asset is the decline in value reduced to the extent you used the asset for a non-taxable purpose; see **Decline in value of a depreciating asset used for a non-taxable purpose** on page 8. Your deduction may also be reduced if the asset is a leisure facility or a boat.

Accelerated rates of depreciation

Use the tables below only if you are able to use accelerated depreciation; see **Accelerated depreciation** on page 8. You use the rate that corresponds to the effective life of the item of plant. The following tables show the appropriate rates.

The accelerated rates in table 1 apply to most general items of plant acquired before 1 July 2001 with an effective life of more than thirteen years.

Table 1: Accelerated rates of depreciation for general items of plant

Effective life in years	Prime cost rate %	Diminishing value rate %
13 to less than 30	13	20
30 or more	7	10

The rates in table 2 apply to cars and motorcycles acquired before 1 July 2001.

Table 2: Accelerated rates of depreciation for cars and motorcycles

Effective life in years	Prime cost rate %	Diminishing value rate %
13 to less than 20	8	11.25
20 to less than 40	5	7.5
40 or more	3	3.75

GUIDELINES FOR USING THE LOW-VALUE POOL WORKSHEET

See the low-value pool worksheet on page 44.

Description of low-value asset: In this column include a brief description of any low-value assets you allocated to the pool for the current year. A low-value asset is a depreciating asset (other than a horticultural plant) that is not a low-cost asset but that has an opening adjustable value of less than $1,000 worked out using the diminishing value method.

Opening adjustable value of low-value asset: The adjustable value of any depreciating asset at any time is its cost (first and second elements) reduced by any decline in value up to that time. The opening adjustable value of an asset for an income year is generally the adjustable value at the end of the previous income year.

Taxable use percentage: When you allocate an asset to a low-value pool, you must make a reasonable estimate of the percentage of your use of the asset that will be for a taxable purpose over its effective life (for a low-cost asset) or its effective life remaining at the start of the income year it was allocated to the pool (for a low-value asset).

Reduced opening adjustable value of low-value asset: This is the taxable use percentage of the opening adjustable value of any low-value asset you have allocated to the pool for the income year.

Description of low-cost asset or second element of cost of asset in pool: In this column include a brief description of any low-cost assets you allocated to the pool for the income year. A low-cost asset is a depreciating asset (other than a horticultural plant) whose cost (first and second elements) as at the end of the year in which the start time occurred is less than $1,000. Also show in this column a description of any amounts included in the second element of cost of any assets in the pool at the end of the previous year and of any low-value assets allocated for this year. The second element of an asset's cost is capital expenditure on the asset which is incurred after you start to hold it, such as a cost of improving the asset; see **The cost of a depreciating asset** on page 14.

Cost of low-cost asset and **Second element of cost:** Include the cost after you have made any adjustments, such as for GST input tax credits; see **The cost of a depreciating asset** on page 14.

Reduced cost of low-cost asset or second element of cost: This is the taxable use percentage multiplied by:

- the cost of each low-cost asset you allocated to the pool for the income year
- any amounts included in the second element of cost for the income year for
  - assets in the pool at the end of the previous year
  - low-value assets which you allocated to the pool in the current income year.

Balancing adjustment events: Generally, a balancing adjustment event occurs for a depreciating asset if you stop holding it (for example, if you sell it) or you stop using it and you expect never to use it again; see **What happens if you no longer hold or use a depreciating asset?** on page 17.

Termination value: Generally, the termination value is what you receive or are taken to have received for the asset as a result of a balancing adjustment event, such as the proceeds from selling the asset; see **Termination value** on page 18.

Reduced termination value: This is the taxable use percentage of the asset's termination value. Use the taxable use percentage you estimated when you allocated the asset to the pool. This reduced termination value decreases the amount of the closing pool balance. If it exceeds the amount of the closing pool balance, make that balance zero and include the excess in assessable income. If you use the asset for a non-taxable purpose, a capital gain or capital loss may arise when a balancing adjustment event occurs for the asset; see **Balancing adjustment event for a depreciating asset in a low-value pool** on page 24.

WORKSHEET 1: DEPRECIATING ASSETS

Primary production only ☐ Non-primary production only ☐

Description of asset	Date of acquisition	Cost	Opening adjustable value	Balancing adjustment events				Decline in value				Taxable use percentage	Deduction for decline in value		Adjustable value at end of year
				Date	Termination value	Balancing adjustment amounts		Effective life	Percentage rate	Prime cost	Diminishing value		Prime cost	Diminishing value	
						Assessable	Deductible								
					Subtotal			Amount to be claimed as a deduction Do not include in **Total deduction for decline in value**				Totals			
					Less balancing adjustment relief										
					Assessable income Do not include in **Total deduction for decline in value**							**Total deduction for decline in value**			

WORKSHEET 2: LOW-VALUE POOL

Description of low-value asset (LVA)	(a) Opening adjustable value (OAV) of LVA	(b) Taxable use percentage	Reduced OAV of LVA (a) × (b)	Description of low-cost asset (LCA) or second element of cost of asset in pool	(c) Cost of LCA	(d) Second element of cost	(e) Taxable use percentage	Reduced cost of LCA or reduced second element of cost [(c) or (d)] × (e)
Total		Subtotal	A	Totals			Subtotal	E
	Add closing pool balance for previous income year		B				E × 18.75%	F
	Sum of **A** and **B**		C	Decline in value (**D** + **F**)		G		
	C × 37.5%		D	Closing pool balance (**C** + **E** – **G** – **H**)		I*		

Balancing adjustment events

Description of asset for which balancing adjustment event occurred	(f) Termination value (TV)	(g) Taxable use percentage	(h) Reduced TV (f) × (g)
		Totals	H

* If amount at **I** would otherwise be negative, include that amount in your assessable income as a balancing adjustment amount and reduce the amount shown at **I** to zero.

MORE INFORMATION

INTERNET

- For general tax information and up-to-date and comprehensive information about deductions, go to **ato.gov.au**

PUBLICATIONS

Publications referred to in this guide are:

- *Practice Statement Law Administration PS LA 2003/8 – Practical approaches to low-cost business expenses*
- *Guide to capital gains tax 2020* (NAT 4151)
- *Income Tax Assessment Act 1997*
- *Rental properties 2020* (NAT 1729)
- *Research and development tax incentive schedule instructions 2020* (NAT 6709)
- *Taxation Ruling TR 2019/5 Income tax: effective life of depreciating assets (applicable from 1 July 2019)*
  - *Taxation Ruling TR 2018/4W – Income tax: effective life of depreciating assets (applicable from 1 July 2018)*
  - *Taxation Ruling TR 2017/2W – Income tax: effective life of depreciating assets (applicable from 1 July 2017)*
  - *Taxation Ruling TR 2016/1W – Income tax: effective life of depreciating assets (applicable from 1 July 2016)*
  - *Taxation Ruling TR 2015/2W – Income tax: effective life of depreciating assets (applicable from 1 July 2015)*
  - *Taxation Ruling TR 2014/4W – Income tax: effective life of depreciating assets (applicable from 1 July 2014)*
  - *Taxation Ruling TR 2013/4W – Income tax: effective life of depreciating assets (applicable from 1 July 2013)*
  - *Taxation Ruling TR 2012/2W – Income tax: effective life of depreciating assets (applicable from 1 July 2012)*
  - *Taxation Ruling TR 2011/2W – Income tax: effective life of depreciating assets (applicable from 1 July 2011)*
  - *Taxation Ruling TR 2010/2W – Income tax: effective life of depreciating assets (applicable from 1 July 2010)*
  - *Taxation Ruling TR 2009/4W – Income tax: effective life of depreciating assets (applicable from 1 July 2009)*
  - *Taxation Ruling TR 2008/4W – Income tax: effective life of depreciating assets (applicable from 1 July 2008)*
  - *Taxation Ruling TR 2007/3W – Income tax: effective life of depreciating assets (applicable from 1 July 2007)*
  - *Taxation Ruling TR 2006/15W – Income tax: effective life of depreciating assets (applicable from 1 January 2007)*
  - *Taxation Ruling TR 2006/5W – Income tax: effective life of depreciating assets*
  - *Taxation Ruling TR 2000/18W – Income tax: depreciation effective life (including addendums)*
- *Taxation Ruling IT 2685W – Income tax: depreciation*
- *Taxation Ruling TR 2016/3 Income tax: deductibility of expenditure on a commercial website*
- *Taxpayers' charter – what you need to know* (NAT 2548)

To get any publication referred to in this guide:

- go to **ato.gov.au/publications**, or
- phone **1300 720 092**

PHONE

We can offer a more personalised service if you provide a tax file number (TFN).

- **Individual** **13 28 61**
  Individual income tax and general personal tax enquiries including capital gains tax.
- **Business** **13 28 66**
  Information about business income tax, fringe benefits tax (FBT), fuel tax credits (FTC), goods and services tax (GST), pay as you go (PAYG) and activity statements, including lodgment and payment, accounts and business registration (including Australian business number and tax file number), and dividend and royalty withholding tax.
- **Superannuation** **13 10 20**

OTHER SERVICES

If you do not speak English well and need help from the ATO, phone the Translating and Interpreting Service (TIS National) on **13 14 50**.

If you are deaf or have a hearing or speech impairment, you can phone us through the National Relay Service (NRS) on the numbers listed below, and ask for the ATO number you need:

- TTY users, phone **13 36 77**. For ATO 1800 free call numbers, phone **1800 555 677**.
- Speak and Listen (speech to speech relay) users, phone **1300 555 727**. For ATO 1800 free call numbers, phone **1800 555 727**.
- Internet relay users, connect to **internet-relay.nrscall.gov.au**

LODGE ONLINE

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- Information from employers, banks and government agencies is pre-filled, saving you time and effort.
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For more information about our lodgment options, go to **ato.gov.au/lodgeonline**

Guide to depreciating assets 2020