

JOINT SUBMISSION BY

Tax and Super Australia, Chartered Accountants Australia and New Zealand,
The Tax Institute, CPA Australia and
Institute of Public Accountants

Draft Taxation Ruling TR 2017/D1

Income tax: composite items and identifying the depreciating asset for the purposes of working out capital allowances

Date: 3 March 2017

The Professional Bodies welcome the opportunity to comment on Draft Taxation Ruling TR 2017/D1 (“the Draft Ruling”). The Draft Ruling considers:

1. how to determine whether a composite item is itself a depreciating asset or whether its components are separate depreciating assets for the purposes of Division 40; and
2. whether an ‘interest in an underlying asset’ for the purposes of s40-35 requires an entity to have an interest in all parts of a depreciating asset, or whether an interest in any part of the asset is enough.

All legislative references are to the *Income Tax Assessment Act 1997* unless otherwise stated.

GENERAL COMMENTS

Overall, the Professional Bodies agree with the Commissioner’s preliminary views that:

1. in determining whether a composite item is a single depreciating asset or whether each of its component parts are separate depreciating assets, regard should be had for the five guiding principles set out in paragraph 6 of the Draft Ruling; and
2. an ‘interest in an underlying asset’ refers to both a partial interest in the entirety of a composite item and a whole interest in a particular component of a composite item.

We are pleased to see 14 practical examples that should assist users of the Ruling once finalised. Herein we include some suggestions for improving the usefulness of these examples even further.

We also include a recommendation in relation to the definition of ‘composite item’ contained in the proposed binding section of the Ruling in order to improve clarity.

SPECIFIC COMMENTS

Definition of composite items

The second sentence of paragraph 4 sets out the legislated directive determining whether a composite item is itself a depreciating asset or whether one or more components are separate depreciating assets is a question of fact and degree. While the provision (s40-30(4)) has been duly referenced in the footnotes, it would be preferable to incorporate the reference into paragraph 4 itself.

This is to provide clarity to readers that the directive is legislated and it is not a view or an interpretation of the Commissioner. By contrast, the definition of the term ‘composite item’ as expressed in the first sentence of paragraph 4 is not a statutory definition. This definition needs to be easily distinguishable from the s40-30(4) *methodology* of determining the appropriate depreciating asset.

Practical examples

Example 2 – Desktop computer package

In relation to Example 2, we agree with the conclusion that the original computer package is one single depreciating asset.

However, paragraph 30 requires some clarity. It states that the subsequent acquisition of 'replacement' elements of the single asset will be treated as the acquisition of separate depreciating assets.

If the monitor in the computer package (composite item) is broken and replaced, the outcome of applying paragraph 30 is that the new monitor will constitute a separate depreciating asset apart from the original computer package asset.

In Example 9, the replacement of an electricity pole which was destroyed in a storm does not create a new depreciating asset separate from the distribution line (ie. the composite asset) of which the relevant pole is a part. The ATO is of the view that there has been no substantial alteration to the function of the depreciating asset. Why then would the replacement of a broken monitor, being one composite part of the overall 'desktop computer package' asset, not give rise to the same outcome?

If the above commentary in fact represents a misinterpretation of paragraph 30, please reword the paragraph to clarify the circumstances in which the 'replacement' of one component will and will not constitute the acquisition of a depreciating asset separate from the original composite item.

Example 3 – Mainframe computer

Example 3 can be improved by incorporating pertinent facts about the 20 new terminals into paragraph 33. In particular, their 'adaptability to work with a wide range of controllers' (paragraph 35) and any other factors that differentiate the 20 new terminals from the 50 original terminals should be stated in paragraph 33 – before the analysis and conclusion. The current drafting of paragraph 33 leaves the reader with the impression that the 20 new terminals are identical to the 50 original terminals, with a reasonable expectation that the new terminals would be treated the same as the original ones – ie. included as part of the original depreciating asset (as second element of cost).

If the new terminals pass the 'identifiable' test, the features which allow them to perform a function separate to the rest of the system needs to be clearly set out in paragraph 33.

If however they have no identifiable function independent of the mainframe or other controlling device to which they are connected, please expand on the reasons why they would not simply be treated as an improvement to the original asset with the acquisition costs included in the second element of the cost of the original asset.

Example 6 – Car GPS

For completeness, Example 6 can be expanded with commentary on the Division 40 treatment in a situation where a car dashboard is modified to install an in-built GPS bracket or holder, but the GPS unit itself is removable, portable and able to be used away from the car. This is distinct from the scenario contained in paragraph 47, where presumably the portable GPS is merely used inside the car without involving any permanent modification to the car interior.

Presumably, the costs of modifying the car to install the bracket/holder and associated electrical components would be included in the second element of the cost of the car, while the removable GPS unit itself would be treated as a separate depreciating asset.

Additional example – intangible asset

We recommend that the final Ruling includes a practical example relating to a common intangible asset that is relevant to many or most taxpayers. Even though there is commentary on intangible assets in the binding part of the Ruling and in the explanatory Appendix 1, all of

the 14 practical examples in the Draft Ruling relate to tangible items.

An ideal example is copyright in software. In the modern business environment, the sale and purchase of software is very common. ATO ID 2004/982 may be a suitable scenario on which to base the example. In the ID, the taxpayer developed a new software program to a prototype stage. Another party purchased the program in that stage of development and all intellectual property rights subsisting in it. The ID shows the application of the function test to the software. Accordingly, the ID concludes that the relevant depreciating asset is the copyright in the latest version of the computer program before it was sold.

We acknowledge that Appendix 1 to the Draft Ruling provides the example of the Full Federal Court case of *Mitsui*, in which the intangible asset was a production licence relating to petroleum exploration and recovery. However, an example would be more useful to users of the Ruling if it is contained within the practical examples section of the Ruling and concerns a much more common type of intangible asset that is held by a broader selection of taxpayers.