Guide for taxpayers with depreciating assets

Guide to depreciating assets 2011

To help you complete your tax return for 1 July 2010 – 30 June 2011

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

For more information visit **www.ato.gov.au**

NAT 1996–6.2011

Australian Government
Australian Taxation Office

OUR COMMITMENT TO YOU

We are committed to providing you with accurate, consistent and clear information to help you understand your rights and entitlements and meet your obligations.

If you follow our information in this publication and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we must still apply the law correctly. If that means you owe us money, we must ask you to pay it but we will not charge you a penalty. Also, if you acted reasonably and in good faith we will not charge you interest.

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If you feel that this publication does not fully cover your circumstances, or you are unsure how it applies to you, you can seek further assistance from us.

We regularly revise our publications to take account of any changes to the law, so make sure that you have the latest information. If you are unsure, you can check for more recent information on our website at **www.ato.gov.au** or contact us.

This publication was current at **May 2011**.

HOW SELF-ASSESSMENT AFFECTS YOU

Self-assessment means the ATO uses the information you give on your tax return and any related schedules and forms to work out your refund or tax liability. We do not take any responsibility for checking the accuracy of the details you provide, although our system automatically checks the arithmetic.

Although we do not check the accuracy of your tax return at the time of processing, at a later date we may examine the details more thoroughly by reviewing specific parts, or by conducting an audit of your tax affairs. We also have a number of audit programs that are designed to continually check for missing, inaccurate or incomplete information.

What are your responsibilities?

It is your responsibility to lodge a tax return that is signed, complete and correct. Even if someone else – including a tax agent – helps you to prepare your tax return and any related schedules, you are still legally responsible for the accuracy of your information.

What if you lodge an incorrect tax return?

If you become aware that your tax return is incorrect, you must contact us straight away.

Initiatives to complement self-assessment

There are a number of systems and entitlements that complement self-assessment, including:

- the private ruling system (see below)
- the amendment system (if you find you have left something out of your tax return)
- your entitlement to interest on early payment or over-payment of a tax debt.

Do you need to ask for a private ruling?

If you are uncertain about how a tax law applies to your personal tax affairs, you can ask for a private ruling. To do this, complete a *Private ruling application form (not for tax professionals)* (NAT 13742), or contact us.

Lodge your tax return by the due date, even if you are waiting for the response to your application. You may need to request an amendment to your tax return once you have received the private ruling.

We publish all private rulings on our website. (Before we publish we edit the text to remove information that would identify you.)

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CONTENTS

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 2011 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 the uniform capital allowance system (UCA) for capital expenditure other than on depreciating assets.

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 32.

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

For an explanation of any unfamiliar terms used throughout this guide, see **Definitions** on page 35. They are shown in bold when first used.

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 system

CARBON SINK FORESTS

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

- For such trees established in the 2007–08, 2008–09, 2009–10, 2010–11 or 2011–12 income year, you can claim an immediate deduction for the expenditure you incur in establishing the trees.
- For such trees established in the 2012–13 or a later income year, 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 new rules in Subdivision 40-J of the *Income Tax Assessment Act 1997* and further information at **www.ato.gov.au**

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.

From 1 July 2001, the UCA applies to most depreciating assets, including plant. Under the 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 Commissioner has released *Law Administration Practice Statement PS LA 2003/8 – Taxation treatment of expenditure on low cost items for taxpayers carrying on a business*. This Practice Statement 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 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 goods and services tax, 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.

THE UNIFORM CAPITAL ALLOWANCE SYSTEM

The UCA provides a set of general rules that applies across a variety of depreciating assets and certain other capital expenditure. It does this by consolidating a range of former capital allowance regimes. The UCA replaces provisions relating to:

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

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

It also introduces new deductions for types of capital expenditure that did not previously attract a deduction, such as certain business and project-related costs; see **Capital expenditure deductible under the UCA** on page 27.

You use the UCA 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 32.

Steps to work out your deduction

Under the 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 the UCA? See **What is a depreciating asset?** in the next column.
- 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** on page 11.
- 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 24
- 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 your recognised tax adviser or the ATO.

Depreciating assets excluded from the UCA

Deductions for the decline in value of some depreciating assets are not worked out under the UCA. These 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 or the 12% of original value method for calculating car expenses; these methods take the decline in value into account in their 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 by legal time in the Australian Capital Territory (ACT) 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

- eligible work-related items, such as laptop computers, personal digital assistants, 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 (there is no deduction available to you for the decline in value of such items).
- depreciating assets for which deductions are 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 your recognised tax adviser or the ATO.

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 2010–11 is $57,466; see **Car limit** on page 15.

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 the 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 the cost of the car is limited to the car limit for the year in which the lease is granted.

Any deduction must be reduced to reflect any use of the car other than for a taxable purpose, such as private use.

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 the UCA rules, 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 21.

Leased depreciating assets fixed to land

If you are the lessee of a depreciating asset and it is affixed 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 it.

However, Jo also holds the machinery as it is attached to her land. She is entitled to a deduction for the decline in value based on the cost to her to hold the machinery. This 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 holds 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 exists.

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 holds 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 and 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

From 1 July 2001, deductions for the decline in value of most depreciating assets, including those acquired before that date, are worked out under the UCA rules.

The UCA contains 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 7.

The general rules do not apply to some depreciating assets. The UCA provides 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 9
- 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 24
- depreciating assets used in exploration or prospecting; see **Mining and quarrying, and minerals transport** on page 29
- water facilities and horticultural plants (including grapevines); see **Primary production depreciating assets** on page 25
- certain depreciating assets of primary producers, other landholders and rural land irrigation water providers used in landcare operations; see **Landcare operations** on page 28
- certain depreciating assets of primary producers and other landholders used for electricity connections or phone lines; see **Electricity connections and phone lines** on page 29.

There are also specific rules for working out deductions for depreciating assets used in carrying on research and development activities; see *Research and development tax concession schedule instructions 2011* (NAT 6709) for more information.

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 35).

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: the prime cost method or the diminishing value method. You can generally choose to use either method for each depreciating asset you hold.

Once you have chosen a method for a particular asset, you cannot change to the other method for that asset.

The decline in value calculator at **www.ato.gov.au** will help you with the choice and the calculations.

In some cases, you do not need to make the choice because 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 9.

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 24, and **Low-value pools** on page 22.

Both the diminishing value and prime cost 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** on page 11.

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. Adjustable value is similar to the concept of undeducted cost used in the former depreciation rules. 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 to 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 8, and **Decline in value of boats** on page 8.

The diminishing value method

The diminishing value method assumes that the decline in value each year is a constant proportion of the remaining value and produces a progressively smaller decline over time. For depreciating assets that you started to hold on or after 10 May 2006 the formula for the decline in value is:

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

*can be 366 in a leap year

where 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, the base value is the asset's opening adjustable value for that year plus any amounts included in the asset's **second element of cost** for that year.

Generally, you can use this formula to work out the decline in value of an eligible depreciating asset if you started to hold it on or after 10 May 2006. However, this formula may not apply in some cases, for example, if you held an asset before 10 May 2006 but then disposed of it and reacquired it on or after 10 May 2006 just so that you could use this formula to work out the asset's decline in value.

For depreciating assets you started to hold prior to 10 May 2006 the formula for the decline in value is:

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

*can be 366 in a leap year

EXAMPLE: Base value, ignoring any GST impact

Leo purchased a computer for $6,000. The computer's base value in its start year would be its cost of $6,000. If the computer's decline in value for that year is $1,500 and no amounts are included in the second element of the computer's cost, its base value for the next income year would be its opening adjustable value of $4,500. This amount is the cost of the computer of $6,000 less its decline in value of $1,500.

'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. If the income year is the one in which the asset's start time occurs, you work out the days held from its start time. If a **balancing adjustment event** occurs for the asset during the income year (for example, if you sell it), you work out the days held up until the day the balancing adjustment event occurred; see **What happens if you no longer hold or use a depreciating asset?** on page 17 for information about balancing adjustment events.

EXAMPLE: Diminishing value method, ignoring any GST impact

Laura purchased a photocopier on 1 July 2010 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 the 2010–11 income year would be $600. This is worked out as follows:

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

If Laura used the photocopier wholly for taxable purposes in that income year, she would be entitled to a deduction equal to the decline in value. The adjustable value of the asset at 30 June 2011 would be $900. This is the cost of the asset ($1,500) less its decline in value up to that time ($600).

The prime cost method

The prime cost method assumes that the value of a depreciating asset decreases uniformly over its effective life. The formula for the annual decline in value using the prime cost method is:

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

*can be 366 in a leap year

EXAMPLE: Prime cost method, ignoring any GST impact

Using the facts of the previous example, if Laura chose to work out the decline in value of the photocopier using the prime cost method, the decline in value for the 2010–11 income year would be $300. This is worked out as follows:

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

If Laura used the photocopier wholly for taxable purposes in that income year, she would be entitled to a deduction equal to the decline in value. The adjustable value of the asset at 30 June 2011 would be $1,200. This is the cost of the asset ($1,500) less its decline in value up to that time ($300).

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** on page 11
- an amount is included in the second element of an asset's cost after the 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 16
- 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 16.

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. The formula for the decline in value is:

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

*can be 366 in a leap year

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 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 12.

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 the UCA; see **Accelerated depreciation** on the next page.

Accelerated depreciation

For plant acquired between 27 February 1992 and 11.45am (by legal time in the ACT) 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.

Generally, accelerated rates of depreciation have not been available for plant acquired after 11.45am (by legal time in the ACT) 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 the 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 37.

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 the 2010–11 income year, Peter continues to use the same cost, method and rate that he was using before the start of the UCA.

The decline in value of the machine for the 2010–11 income year is $7,000, worked out as follows:

asset's cost	×	$\frac{\text{days held*}}{365}$	×	prime cost rate
100,000	×	$\frac{365}{365}$	×	7%

*can be 366 in a leap year

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 to 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 purchased a computer for $6,000 and used it only 50% of the time for a taxable purpose during the income year. If the computer's decline in value for the income year is $1,500, Leo's deduction would be reduced to $750, being 50% of the computer's decline in value for the income year. The adjustable value at the end of the income year would be $4,500, irrespective of the extent of Leo's use of the asset for taxable purposes.

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

Paul purchased a refrigerator on 1 July 2008 and immediately used it wholly for private purposes. He started a new business on 1 March 2011 and then used the refrigerator wholly in his business. Paul's refrigerator started to decline in value from 1 July 2008 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 2011 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

Your deduction for the decline in value of a boat that you use or hold may be reduced if the total of the amounts that you could otherwise deduct in respect of the use or holding of the boat exceeds your assessable income from using or holding the boat. The total amount of the deductions is reduced 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 13.

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 13.

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** below
- 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** on the next page, and
- 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 the next page, 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 the next page.

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.

The immediate deduction is not available for the following depreciating assets:
- certain water facilities and horticultural plants, including grapevines; see **Primary production depreciating assets** on page 25
- certain depreciating assets of primary producers, other landholders and rural land irrigation water providers used in landcare operations; see **Landcare operations** on page 28
- certain depreciating assets of primary producers and other landholders used for electricity connections or phone lines; see **Electricity connections and phone lines** on page 29
- in-house software if you have allocated expenditure on it to a software development pool; see **Software development pools** on page 24.

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 rental property, and
- 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, Rob 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 the 2010–11 income year, 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 the 2010–11 income year, 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 2011 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 kitchen stools for her rental property in the 2010–11 income year. 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 their total cost exceeds $300.

EXAMPLE: Not substantially identical items

Jan also buys some 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

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. It 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 the next page
- 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

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 (by legal time in the ACT) 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 is *Taxation Ruling TR 2010/2 – Income tax: effective life of depreciating assets (applicable from 1 July 2010)*, which lists the Commissioner's determinations of the effective life for various depreciating assets.

You need to work out which of the following apply:

- Taxation Ruling TR 2010/2 (from 1 July 2010)
- Taxation Ruling TR 2009/4 (from 1 July 2009 to 30 June 2010)
- Taxation Ruling TR 2008/4 (from 1 July 2008 to 30 June 2009)
- Taxation Ruling TR 2007/3 (from 1 July 2007 to 30 June 2008)
- Taxation Ruling TR 2006/15 (from 1 January 2007 to 30 June 2007)
- Taxation Ruling TR 2006/5 (from 1 July 2006 to 31 December 2006)
- Taxation Ruling TR 2000/18 (from 1 January 2001 to 30 June 2006), or
- Taxation Ruling IT 2685.

As a general rule, the table of effective lives accompanying Taxation Ruling IT 2685 should be used only for depreciating assets:

- acquired under a contract entered into
- otherwise acquired, or
- started to be constructed

before 1 January 2001.

> **NOTE**
> Taxation Ruling IT 2685 contains depreciation rates (accelerated rates and broadbanded rates) which you should use only for plant that was acquired before 11.45am (by legal time in the ACT) on 21 September 1999 or by certain small business taxpayers before 1 July 2001; see **Accelerated depreciation** on page 8.

For an extract from Taxation Ruling TR 2010/2 showing the effective lives of some commonly used depreciating assets, see **Examples of effective lives from Taxation Ruling TR 2010/2 (from 1 July 2010)**, on page 36.

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 with 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 buses, light commercial vehicles, trucks and trailers; and certain assets used in the oil and gas industries. For more information, see Taxation Ruling TR 2010/2.

Effective life of intangible depreciating assets

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

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	$2\frac{1}{2}$ or 4*
9	Spectrum licence	The term of the licence
10	Datacasting transmitter licence	15
11	Telecommunications site access right	The term of the right

* See **In-house software** on page 24 for more information

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 on page 36. 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 cannot be longer than the term of the asset as extended by any reasonably assured extension or renewal of that term.

If you acquire 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

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

Asset		Effective life in years
1	A mining, quarrying or prospecting right relating to mining operations (except obtaining petroleum or quarry materials)	The life of the mine or proposed mine or, if there is more than one, the life of the mine that has the longest life
2	A mining, quarrying or prospecting right relating to mining operations to obtain petroleum	The life of the petroleum field or proposed petroleum field
3	A mining, quarrying or prospecting right relating to mining operations to obtain quarry materials	The life of the quarry or proposed quarry 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 listed in the above table, you will need to work out the effective life yourself. 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 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.

You will also be able to recalculate the effective life of the mining, quarrying or prospecting right if there are 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, or

- a change to the accepted industry practice that affects the estimation of the life of the mine.

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 previous page.

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 11.

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; see **Methods of working out decline in value** on page 6 for information about the adjusted prime cost formula.

DEPRECIATING ASSETS AND TAXATION OF FINANCIAL ARRANGEMENTS

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 will 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 will 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.

Regardless of whether the TOFA rules would otherwise apply to you, they apply to all qualifying securities, acquired during or after the first income year starting on 1 July 2010, that have a remaining life of more than 12 months after you start to have them.

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.

> NOTE
>
> You also show the gains or losses from relevant hedging financial arrangements on the *Capital allowances schedule 2011* (NAT 3424).

For more information see

- *TOFA and the cost of a depreciating asset* (on page 17)
- *TOFA and the termination value of a depreciating asset* (on page 18), or
- *Guide to the taxation of financial arrangements (TOFA) rules* at **www.ato.gov.au/tofa**

THE COST OF A DEPRECIATING ASSET

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

Under the 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). See **What happens if you no longer hold or use a depreciating asset?** on page 17 for information on balancing adjustment events. Such expenses may include advertising or commission expenses or the cost of demolishing the asset.

The first element of a depreciating asset's cost cannot include an amount that forms part of the second element of cost of another depreciating asset. 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 of the asset demolished. The amount is not also included in the first element of cost of the new asset.

> NOTE
>
> 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, the cost of the depreciating asset includes any GST paid.

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
- 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 the next page
- 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 the UCA.

EXAMPLE: Expenditure not of a capital nature and deductible outside the 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.

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 the ATO or your recognised tax adviser.

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.

> NOTE
>
> 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, the cost of the depreciating asset includes any GST paid.

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.

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 2010–11 is $57,466.

Before applying the car limit you may need to:

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

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.

The 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.

The adjustment is only made if the cost of the car (after GST credits or adjustments) plus the discount portion exceeds the car limit and if you or another entity has 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 the previous page.

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 first and second elements of cost.

We generally accept independent valuations as a basis for this apportionment. However, if there is no independent valuation, you may need to demonstrate that your apportionment of the amount paid is reasonable. 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 for information about low-value pools.

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 the *Guide to capital gains tax 2011* (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, and the 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 the publication *Forex: election out of the 12 month rule* (NAT 9344), at **www.ato.gov.au**

TOFA and the cost of a depreciating asset

If the TOFA rules apply to your financial arrangement 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 2010 to buy a depreciating asset for $100,000. The depreciating asset will be delivered in 6 months time on 1 January 2011 and payment will be made on 1 July 2012 (that is, 18 months after delivery). The market value of the depreciating asset on 1 January 2011 is $90,000.

On 1 January 2011 when Aus Co receives the depreciating asset it will start 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 will be $90,000.

The financial arrangement will be taxed separately under the TOFA rules. Any gain or loss worked out under those rules (loss of $10,000 in this example) will 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.

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** on the next page for information about how to work out an asset's termination value.

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 the next page.
- 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.
- 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 24.
- 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.
- 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.
- There are no specific balancing adjustment rules for some primary production depreciating assets (see **Primary production depreciating assets** on page 25) or certain depreciating assets used for landcare operations, electricity connections or phone lines (see **Landcare operations** on page 28 and **Electricity connections and phone lines** on page 29). 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; see the *Research and development tax concession schedule instructions 2011* for more information.

A GST liability will generally occur when a depreciating asset is disposed of by a GST registered entity for more information see the fact sheet *GST and the disposal of capital assets* (NAT 7682), at **www.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 16.

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 18–22. If you are not sure of the termination value of a depreciating asset, contact the ATO 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.

The ATO generally accepts independent valuations as a basis for this apportionment. However, if there is no independent valuation, you may need to demonstrate that your apportionment of the amount is reasonable. Apportionment on the basis of the market values of the various items for which the amount is received will generally be reasonable.

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.

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 parts) 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 2010 to sell its depreciating asset for $100,000. The depreciating asset will be delivered in 6 months time on 1 January 2011 and payment will be received on 1 July 2012 (that is, 18 months after delivery). The market value of the depreciating asset on 1 January 2011 is $90,000.

On 1 January 2011 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 will be taxed separately under the TOFA rules. Any gain or loss worked out under those rules (gain of $10,000 in this example) will 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 or loss will be assessable or deductible on the same basis as for the depreciating asset. Therefore, when there is a balancing adjustment event for that depreciating asset it may be necessary to separately work out:

- 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.

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 24.

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 for information about a low-value pool.

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: Sale of a depreciating asset used partly for a taxable purpose, ignoring any GST impact

Andrew sells a computer for $600. The computer's cost is $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 (the difference between the computer's termination value and its adjustable value 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 the difference between the computer's termination value and its cost.

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 8, and **Decline in value of boats** on page 8) 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.

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 (by legal time in the ACT) 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 (by legal time in the ACT) 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; see **Depreciating asset used for a non-taxable purpose** on the previous page for a list of such assets. 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.

See the *Guide to capital gains tax 2011* for more information about indexation of a cost base and the impact of indexation on discount capital gains.

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.

If you use the one-third of actual expenses method or 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: If you use the one-third of actual expenses method, ignoring any GST impact

Louise acquired a car on 1 July 2009. During both the 2009–10 and 2010–11 income years, Louise used the one-third of actual expenses method to work out her deductions for car expenses. She sold her car for $24,500 on 30 June 2011. At that time, the adjustable value of the car was $18,200.

Louise's balancing adjustment amount is reduced by the amount attributable to her use of the car for a non-taxable purpose. As she used the one-third of actual expenses method to work out her deductions for car expenses, her balancing adjustment amount is reduced by two-thirds. Louise's balancing adjustment would be $2,100, that is, one-third of the difference ($6,300) between the termination value and the adjustable value of the car. Louise must include the amount of $2,100 in her assessable income.

EXAMPLE: If you use the logbook method, ignoring any GST impact

If Louise used the logbook method to work out her deductions for car expenses and her 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 or the 12% of original value method of claiming car expenses, no balancing adjustment amount arises because the decline in value of the car is not worked out separately under those methods. The decline in value is taken into account as part of the calculation of the car expenses. However, if you switch between these methods and the one-third of actual expenses method or the logbook method of claiming car expenses, you may have to work out a balancing adjustment amount. This is 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 the ATO or your recognised tax adviser.

For a car subject to the car limit (see **Car limit** on page 15) you need to reduce the termination value. You multiply the termination value by the following fraction:

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

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 15.

If a lessee under a luxury car lease or a hirer under a hire purchase agreement does not acquire the car when the lease or agreement terminates or ends, they are treated as if they sold the asset to the lessor or financier, respectively. The lessee or hirer 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 the UCA rules, 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.

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 34.

For the 2007–08 income year and later years the roll-over relief available under the UCA rules has been extended to small business entities that choose to claim their capital allowance deductions under the simplified depreciation rules; see **Small business entities** on page 32.

Limited recourse debt arrangements

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), excessive deductions for capital allowances are to be included as assessable income. 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 in working 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 your recognised tax adviser or the ATO.

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.

An example of splitting a depreciating asset is removing a CB radio from a truck. 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 the UCA rules 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 following may differ:
>
> - the method that you use to calculate your foreign currency gain or loss, and
> - the first element of the depreciating asset's cost.
>
> For more information about the TOFA rules, see *Guide to the taxation of financial arrangements (TOFA) rules* in *Taxation of financial arrangements (TOFA)* at **www.ato.gov.au/tofa**

LOW-VALUE POOLS

From 1 July 2000, an optional low-value pooling arrangement for plant was introduced. It applied to certain plant costing less than $1,000 or having an undeducted cost of less than $1,000. Such plant could be allocated to a low-value pool and depreciated at statutory rates.

The UCA adopts 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.

Transitional rules apply so that a low-value pool created before 1 July 2001 continues and is treated as if it were created under the UCA. The closing balance of the pool worked out under the former rules is used to start working out the decline in value of the depreciating assets in the pool under the UCA.

Under the 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) as 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, and
- for which you used the diminishing value method to work out any deductions for decline in value for a previous income year.

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

The following depreciating assets cannot be allocated 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 32
- 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 9
- certain depreciating assets used in carrying on research and development activities; see the *Research and development tax concession schedule instructions 2011* for more information, or
- 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.

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

Allocating depreciating assets to a low-value pool

A low-value pool is created when you first 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
  - 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 the 2010–11 income year, John bought a printer for $990. John allocated low-cost assets to a low-value pool in the 2009–10 income year so he had to allocate the printer to the pool because it too was a low-cost asset. He estimated that only 60% of its use would be for taxable purposes. He therefore allocated only 60% of the cost of the printer to the pool, that is, $594.
>
> Assume that at the end of the 2009–10 income year, John's low-value pool had a closing pool balance of $5,000. Also assume that John did not allocate any other low-cost or low-value assets to the pool for the 2010–11 income year. John's deduction for the decline in value of the assets in the pool for the 2010–11 income year would be $1,986. This is worked out as follows:

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

The **closing balance of a low-value pool** for an income year is:

- the closing pool balance for the previous income year

  plus
- the taxable use percentage of the cost (first and second elements) of any low-cost assets allocated to the pool for the income year

  plus
- the taxable use percentage of the opening adjustable value of low-value assets allocated to the pool for the income year

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

  less
- the decline in value of the assets in the pool for the income year.

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

Following on from the previous example, and assuming that John made no additional allocations to or reductions from his low-value pool, the closing balance of the pool for the 2010–11 income year would be $3,608:

Closing pool balance for the 2009–10 income year	$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 the income year	($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 the 2011–12 income year 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 the 2011–12 income year is $1,955:

Closing pool balance for the 2010–11 income year	$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)

To help you work out your deductions for depreciating assets in a low-value pool, a worksheet is provided on page 40.

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 the 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 the UCA, expenditure on in-house software may be deducted 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 two and a half years (or four years for expenditure made on or after 7.30pm AEST on 13 May 2008) and the prime cost method
- expenditure incurred in developing (or having developed) in-house software may be (or may need to be) allocated to a software development pool; see below
- if expenditure incurred in developing (or having developed) 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 and its decline in value can then be worked out using an effective life of two and a half years (or four years, see previous column) and the prime cost method from the time the software is first used or installed ready for use
- 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 9.

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.

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 the UCA.

Under the UCA rules, 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 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. You are allowed deductions at the rate of 40% in each of the next two years and 20% 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 the UCA. However, if you have allocated plant to a common-rate pool before 1 July 2001, you can continue to claim deductions under the 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 the UCA
- in applying the diminishing value formula for the income year in which the 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.

PRIMARY PRODUCTION DEPRECIATING ASSETS

The general principles of the 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
- horticultural plants, and
- 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.

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. See the *Guide to capital gains tax 2011* for more information.

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 28 and **Electricity connections and phone lines** on page 29.

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 claim a deduction for the decline in value of a water facility in equal instalments over three 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 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 rules. For more information about the simplified depreciation rules, see **Small business entities** on page 32.

You may need to include a recoupment of expenditure on water facilities in your assessable income. As 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.

Horticultural plants

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.

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 2010/2.

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 $6\frac{2}{3}$ years	27%	3 years 257 days
$6\frac{2}{3}$ 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 the UCA rules to work out your deductions for horticultural plants. For more information about the simplified depreciation rules, see **Small business entities** on page 32.

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.

Grapevines

NOTE

The specific rules for working out the decline in value of grapevines only apply to grapevines that are planted and first used by you in a primary production business before 1 October 2004. If a grapevine is planted and first used by you in a primary production business on or after 1 October 2004, the decline in value of the grapevine is worked out under the provisions relating to horticultural plants; see **Horticultural plants** on the previous page.

The decline in value of a grapevine is worked out at a rate of 25%, provided:

- you own the grapevine, or
- the grapevine is established on Crown land that you hold under a quasi-ownership right (such as a lease) and that is used in a primary production business.

If you are not entitled to work out your deduction for decline in value under the provisions relating to grapevines because these conditions are not met, a deduction may be available for decline in value under the provisions relating to horticultural plants; see **Horticultural plants** on the previous page.

Your deduction for the decline in value of grapevines is based on the capital expenditure incurred in establishing the grapevines. Capital expenditure incurred in establishing grapevines does not include the cost of purchasing or leasing land, expenditure on draining swamps or low-lying land, or expenditure on clearing land, but it does include, for example, the cost of:

- preparing the land (ploughing and topsoil enhancement)
- planting the vines, and
- the vines.

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.

You start to deduct the decline in value of grapevines from the time you first use the grapevines in a primary production business to produce assessable income. If ownership of the grapevines changes, the remaining deduction is available to the new owner while they use the grapevines in a primary production business.

If a grapevine is destroyed before the end of the write-off period, you are allowed a deduction in the year of destruction for the remaining unclaimed establishment expenditure less any proceeds, for example, insurance.

If you are a primary producer and small business entity, you must use the UCA to work out your deductions for grapevines. For more information about the simplified depreciation rules, see **Small business entities** on page 32.

A recoupment of expenditure on grapevines may be assessable income. As 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 grapevine for its market value is not regarded as an assessable recoupment.

CAPITAL EXPENDITURE DEDUCTIBLE UNDER THE UCA

The 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 the 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 29
- environmental protection activities (EPA); see **Environmental protection activities** on page 29
- exploration and prospecting; see **Mining and quarrying, and minerals transport** on page 29
- rehabilitation of mining and quarrying sites; see **Mining and quarrying, and minerals transport** on page 29
- petroleum resource rent tax; see **Mining and quarrying, and minerals transport** on page 29
- certain capital expenditure directly connected with a project; see **Project pools** on page 30
- certain business related costs; see **Business related costs – section 40-880 deductions** on page 31.

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 30.

> **NOTE**
>
> Small business entities that have chosen to use the simplified depreciation rules (except primary producers) may deduct capital expenditure under these UCA rules 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 the UCA rules; see **Small business entities** on page 32.

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:

- erecting fences to separate different land classes in accordance with an approved land management plan
- 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
- constructing a levee or similar improvement
- constructing drainage works (other than the draining of swamp or low-lying land) primarily and principally to control salinity or assist in drainage control
- an operation primarily and principally for eradicating or exterminating animal pests from the land
- an operation primarily and principally for eradicating, exterminating or destroying plant growth detrimental to the land
- an operation primarily and principally for preventing or combating land degradation other than by erecting fences
- an extension, alteration or addition to any of the assets described in the first four dot points or an extension of an operation described in the fifth to seventh dot 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 25.

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.

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 rules. For more information about the simplified depreciation rules, see **Small business entities** on page 32.

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 rules. For more information about the simplified depreciation rules, see **Small business entities** on page 32.

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

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 the next page.

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.

However, the decline in value of a depreciating asset 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.

An immediate deduction is available for payments of petroleum resource rent tax and for capital 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, 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.

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 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
- contributions you make in carrying on business to someone else's expenditure on the above items.

For information on how to work out deductions using a project pool, see **Project pools** in the next column.

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 and 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 the 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 have sufficient 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 the previous page) 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.

> NOTE
>
> 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 **www.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

The UCA introduced a five-year write-off for seven specific types of business related capital expenditure incurred after 30 June 2001. Such expenditure, also known as blackhole expenditure, did not previously attract a deduction.

As part of a new treatment for blackhole expenditure, new rules apply to business related capital expenditure incurred after 30 June 2005. Deductions are now allowable for a greater range of such expenditure, provided that no other provision either takes the expenditure into account or denies a deduction. Section 40-880 deductions are no longer limited to the seven specific types of expenditure that were previously deductible.

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.

> **NOTE**
>
> 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 the details under Change 3 in the fact sheet *Blackhole expenditure: business related expenses,* available at **www.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 the fact sheet *Non-commercial losses: overview – factsheet* (NAT 3379) for information on the non-commercial loss rules.

EXAMPLE

> Ralph decides to start carrying on his existing business through a company. The business will continue to be carried on for a taxable purpose. Ralph will be the only shareholder of the company and he will be entitled to receive all the profits from the business. He incurs expenses to incorporate the existing business. Legally, Ralph 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 in connection with the business proposed 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 the UCA or 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, 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.

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 the fact sheet *Non-commercial losses: overview* for information on the non-commercial loss rules.

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

SMALL BUSINESS ENTITIES

From the 2007–08 income year the simplified tax system provisions have been replaced with new streamlined provisions for small business entities. The concessions that were available under the simplified tax system have, in effect, carried over to the new rules. This means that you can gain access to the concessions that were previously available to you as a simplified tax system taxpayer if you meet the new small business eligibility criteria.

For more information, see *Concessions for small business entities* (NAT 71874).

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 $2 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.

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 $1,000 each can be written off immediately
- other depreciating assets with an effective life of less than 25 years are pooled in a general small business pool and deducted at the rate of 30%
- depreciating assets with an effective life of 25 years or more are pooled in a long-life small business pool and deducted at the rate of 5%
- newly acquired assets are deducted at either 15% or 2.5% (half the relevant pool rate) in the first year, regardless of when they were acquired during the year.

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

> **SIMPLIFIED DEPRECIATION**
>
> If a small business entity chooses to stop using the simplified depreciation concession, it cannot again choose to use that concession until at least five years after the income year in which it chose to stop using that concession.

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 the UCA rules.

For more information, see *Concessions for small business entities*.

Assets for which deductions are claimed under the UCA

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

- 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
- 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 the UCA)
- horticultural plants, and
- in-house software where the development expenditure is allocated to a software development pool; see **Software development pools** on page 24.

Capital expenditure deductible under the 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 the UCA rules 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 the UCA** on page 27 for more information.

In-house software

Under the UCA, you can choose to allocate to a software development pool expenditure you incur in developing (or in having developed) 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 24.

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 the UCA.

If:

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

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 two and a half years (or four years for expenditure made on or after 7.30pm AEST on 13 May 2008) and 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.

Primary producers

A small business entity can choose to claim deductions under either the simplified depreciation rules or the UCA for certain depreciating assets used in the course of carrying on a business of primary production. The choice is available for water facilities and for depreciating assets relating to landcare operations, electricity connections and phone lines; see pages 28–29.

You can choose to claim your deductions under the simplified depreciation rules or the 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 the income year
- 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 adjustable value at the end of the income year
- any recoupment of cost you have included in assessable income, and
- if a balancing adjustment event occurs for the asset during the year, the date of the balancing adjustment event, termination value, adjustable value at that time, 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, and
- original documents such as suppliers' invoices and receipts for expenditure on the depreciating asset.

Additional record-keeping requirements apply if you acquire an asset from an associate or if you acquire a depreciating asset but the user is the same or 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 assets and some to the pool):

- the start time of assets in the pool and the date you started holding them
- the closing pool balance at the end of the previous income year
- any second elements of cost incurred for the income year for assets in the pool at the end of the previous income year
- the opening adjustable value of any low-value assets you have allocated to the pool for the income year
- the first element of cost of any low-cost assets allocated to the pool for the income year
- the second element of cost of low-cost assets and low-value assets allocated to the pool for the income year
- the taxable use percentage of each amount added to the pool for the income year
- the termination value and taxable use percentage for any assets in the pool in respect of which a balancing adjustment event occurred during 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.

Because a capital gain or capital loss may arise when a balancing adjustment event occurs

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

you must keep the following information:

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

Generally, records relating to a depreciating asset allocated to a low-value pool must be retained for a period of five years starting from the end of the income year in which the asset is allocated to the pool. However, 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, the records of the cost must be retained for a period of five years from the time the expenditure is incurred.

Records of acquisitions relating to delayed claims for GST input tax credits must be retained for at least five years after lodgment. Therefore, if a claim for input tax credits relates to a depreciating asset in a low-value pool, the record of acquisition may need to be retained for a period of five years which begins later than the end of the income year in which the asset is 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 the UCA rules apply to the transferee's holding of the depreciating asset. Generally, this needs to be done 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, or
- the asset is lost or destroyed

whichever happens earlier.

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 the UCA rules apply to the transferee's holding of the depreciating asset. Generally, the choice needs to 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 for five years after the next balancing adjustment event that occurs for the asset.

COMPLETING THE *CAPITAL ALLOWANCES SCHEDULE 2011*

INDIVIDUAL TAXPAYERS

You do not need to complete a *Capital allowances schedule 2011* (NAT 3424). The requirement to complete a schedule has been removed for individual tax returns from 2011 onwards.

Unless you are a small business entity using the simplified depreciation rules or an individual taxpayer, you need to complete a *Capital allowances schedule 2011* (NAT 3424) if you had more than $100,000 at any of the following labels on your tax return:

Label	Where label found
Depreciation expenses (see note on the next page)	Company, partnership and trust tax returns only
Deduction for decline in value of depreciating assets	Company, fund and self-managed superannuation fund returns only

NOTE

You do not include information in the *Capital allowances schedule 2011* about depreciating assets that are subject to the simplified depreciation rules; for more information see *Concessions for small business entities*.

If the claim for a deduction relates to both existing small business items and UCA items, only complete the schedule for the UCA items.

You should use **worksheet 1: Depreciating assets** and **worksheet 2: Low-value pool** to help you complete your income tax return and the schedule. These worksheets are on pages 39 and 40.

For more information about the *Capital allowances schedule 2011*, see the *Capital allowances schedule instructions 2011* (NAT 4089).

DEFINITIONS

The most commonly used UCA terms are explained here. A comparison of some of the UCA terms with those used in the former depreciation rules is provided in the table below:

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 2010–11 is $57,466.

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, such as the proceeds from selling an asset.

GUIDELINES FOR USING THE DEPRECIATING ASSETS WORKSHEET

The depreciating assets worksheet is on page 39.

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** on page 11. 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** on the next page.

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.

The letters **G**, **H**, **I**, **J** and **K** on the worksheet correspond to labels on the *Capital allowances schedule 2011*. The worksheet will assist if you have to complete the schedule; see **Completing the *Capital allowances schedule 2011*** on page 35.

Examples of effective lives from Taxation Ruling TR 2010/2 (from 1 July 2010)

Depreciating asset	Effective life in years
Carpets	
– in commercial office buildings	8
– in ten-pin bowling centres	4
Computers	
– generally	4
– laptops	3
Curtains and drapes	6
Fire extinguishers	15
Hot water installations for commercial office buildings (excluding commercial boilers and piping)	15
Lawn mower	
– motor	$6\frac{2}{3}$
– self-propelled	5
Library (professional)	10
Motor vehicles	
– cars generally	8
– hire and travellers' cars	5
– taxis	4
– motorcycles and scooters	$6\frac{2}{3}$
Office machines and equipment	
– photocopying machines	5
Point of sale assets	

Depreciating asset	Effective life in years
– cash registers, stand-alone type	10
Power tools (hand operated, air or electric)	5
Power tools (hand operated, battery)	3
Television receivers	
– generally	10
Tools (loose)	5
Vacuum cleaners (electric)	10

Accelerated rates of depreciation

You only use the tables below 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.

For most general items of plant the accelerated rates are as follows (note that the first three categories are unlikely to apply for currently held items as the rates only apply to items acquired before 1 July 2001 with an effective life of less than seven years):

Effective life in years	Prime cost rate %	Diminishing value rate %
Less than 3	100	–
3 to less than 5	40	60
5 to less than $6\frac{2}{3}$	27	40
$6\frac{2}{3}$ to less than 10	20	30
10 to less than 13	17	25
13 to less than 30	13	20
30 or more	7	10

For most cars and motorcycles the following rates apply (note that the first three categories are unlikely to apply for currently held cars and motorcycles as the rates only apply to items acquired before 1 July 2001 with an effective life of less than seven years):

Effective life in years	Prime cost rate %	Diminishing value rate %
Less than 3	100	–
3 to less than 5	33	50
5 to less than $6\frac{2}{3}$	20	30
$6\frac{2}{3}$ to less than 10	15	22.5
10 to less than 13	10	15
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

The low-value pool worksheet is on page 40.

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.

The letters **L**, **M**, **N**, **O**, **P** and **Q** on the worksheet correspond to labels on the *Capital allowances schedule 2011*. The worksheet will assist if you have to complete the schedule; see **Completing the *Capital allowances schedule 2011*** on page 35.

WORKSHEET 1: DEPRECIATING ASSETS

Primary production only ☐ Non-primary production only ☐

				Balancing adjustment events				Decline in value					Deduction for decline in value		
Description of asset	Date of acquisition	Cost	Opening adjustable value	Date	Termination value	Balancing adjustment amounts		Effective life	Percentage rate	Prime cost	Diminishing value	Taxable use percentage	Prime cost	Diminishing value	Adjustable value at end of year
						Assessable	Deductible								
					Subtotal		H	Amount to be claimed as a deduction Do not include in **Total deduction for decline in value**				Totals	I	J	K
					Less balancing adjustment relief										
					Assessable income Do not include in **Total deduction for decline in value**	G						**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	**N**	Subtotal	**A**	Totals	**M**	**O**	Subtotal	**E**
		Add closing pool balance for previous income year	**L**				**E** × 18.75%	**F**
		Sum of **A** and **L**	**C**		Decline in value (**D** + **F**)	**G**		
		C × 37.5%	**D**		Closing pool balance (**C** + **E** – **G** – **H**)	**P***		

* If amount at **P** would otherwise be negative, include that amount in your assessable income as a balancing adjustment amount and reduce the amount shown at **P** to zero.

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)
	Q	Totals	**H**

MORE INFORMATION

INTERNET

- For general tax information and up-to-date and comprehensive information about deductions, go to **www.ato.gov.au**

PUBLICATIONS

Publications referred to in this guide are:

- *Blackhole expenditure: business related expenses*
- *Capital allowances schedule 2011* (NAT 3424)
- *Capital allowances schedule instructions 2011* (NAT 4089)
- *Concessions for small business entities* (NAT 71874)
- *Forex: election out of the 12 month rule* (NAT 9344)
- *GST and the disposal of capital assets* (NAT 7682)
- *Guide to capital gains tax 2011* (NAT 4151)
- *Income Tax Assessment Act 1997*
- *Law Administration Practice Statement PS LA 2003/8 – Taxation treatment of expenditure on low cost items for taxpayers carrying on a business.*
- *Non-commercial losses: overview – fact sheet* (NAT 3379)
- *Private ruling application form (not for tax professionals)* (NAT 13742)
- *Research and development tax concession schedule instructions 2011* (NAT 6709)
- *Taxation Ruling TR 2010/2 – Income tax: effective life of depreciating assets (applicable from 1 July 2010)* (which replaced *Taxation Ruling 2009/4 – Income tax: effective life of depreciating assets (applicable from 1 July 2009), Taxation Ruling TR 2007/3 – Income tax: effective life of depreciating assets (applicable from 1 July 2007), Taxation Ruling 2006/15 – Income tax: effective life of depreciating assets (applicable from 1 January 2007), Taxation Ruling 2006/5 – Income tax: effective life of depreciating assets and Taxation Ruling 2000/18 – Income tax: depreciation effective life* and *Taxation Ruling IT 2685 – Income tax: depreciation).*
- *The Taxpayers' Charter* (NAT 2548)
- *The simplified tax system – a guide for tax agents and small businesses* (NAT 6459)

To get any publication referred to in this guide:

- go to **www.ato.gov.au/publications**
- phone **1300 720 092**, or
- visit one of our shopfronts.

For our shopfront addresses you can visit our website.

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 on **13 14 50**.

If you are **deaf** or have a **hearing or speech impairment**, phone the ATO 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 the NRS at **www.relayservice.com.au**

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Guide to depreciating assets 2011