TR 2012/7EC - Compendium

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This edited version of the Compendium of Comments is not intended to be relied upon. It provides no protection from primary tax, penalties, interest or sanctions for non-compliance with the law.

Ruling Compendium – TR 2012/7

This is a compendium of responses to the issues raised by external parties to draft Taxation Ruling TR 2012/D3 *Income tax: capital allowances: treatment of open pit mine site improvements.*

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft Ruling.

Summary of issues raised and responses

Issue No.	Issue raised	ATO Response/Action taken
1.	**Scope of the ruling** A clearer indication in the 'What this Ruling is about' section that the ruling is only applicable to open pit mining operations as opposed to other forms of mining operations such as strip mining or underground mining.	**Agree.** Text added at paragraph 1 to confirm that this Ruling applies only to open cut mining operations. New paragraphs 4 to 6 inserted in the Ruling to provide a description of the open cut mining method.
2.	**Interpretation of subsection 40-30(3)** Each structural operation of man in respect of the mining operation should be regarded as constituting a separate improvement to land and therefore a separate depreciating asset. Case law (*Morrison* and *Oldfield* cited) and the wording of subsection 40-30(3) of the *Income Tax Assessment Act 1997* (ITAA 1997) stated to support this position.	**Disagree.** Text added at paragraphs 10 to 13 of the Ruling to provide a clearer interpretation of subsection 40-30(3)of the ITAA 1997. We consider that the case law identified does not require each component to be viewed as individual improvements to land. It is the entire pit that delivers the enhancement of the use of land to the miner.
3.	**Identification of the appropriate depreciating asset** Submissions suggested: • separate pits can be identified by stage life as identified in the mine plan; • the pit wall (or the components of the pit wall) have a separate functionality to the haulage roads and as such are separate depreciating assets. Each pit wall and haulage road would have an individual effective life;	**Disagree.** Text revised at paragraphs 21 to 25 of the Ruling to clarify the interpretative approach to asset identification. The Ruling now provides that subsection 40-30(4) of the ITAA 1997 is unlikely to apply as the pit is arguably not a 'composite item' as that phrase appears in subsection 40-30(4).

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3. cont	• taxpayers are permitted to make reasonable judgments in identifying the depreciating asset and provided that the assets identified are in truth capable of being treated as separate assets it should not matter that alternative assets could also reasonably be identified (by analogy with the judgment of Thomas J at first instance in *FCT v Tully Co-operative Sugar Milling Association Ltd* 82 ATC 4454); • interpretation of subsection 40-30(4) of the ITAA 1997 is flawed and analogy to the 'car example' in subsection 40-30(4) erroneous; • too much reliance on the 'functionality test'. Difficulty in applying the functionality test to an improvement to land that is a deemed asset that would otherwise be part of the land and not a depreciating asset; • incorrect and prescriptive application of the 'functionality test'; • the deemed asset created in subsection 40-30(3) of the ITAA 1997 cannot be an 'item' as identified in subsection 40-30(4) of the ITAA 1997. Separate improvements cannot be aggregated to create a 'composite item' as required by subsection 40-30(4).	The Ruling continues to consider an application of subsection 40-30(4) of the ITAA 1997 in the alternative that the composite item provision applies. The ATO view of the application of that subsection to a pit has not changed – none of the separately described elements of a pit would be objectively identified as separate depreciating assets by subsection 40-30(4). We consider our application of a function test to be appropriate in the context of an open cut mining operation. The identification of the depreciating asset is an objective test to be applied in the context of Division 40. Decisions of a taxpayer in the context of the self-assessment system in identifying a depreciating asset must be consistent with the objective nature of the test and case law. Since individual features of a pit are in truth not capable of separate existence, the Commissioner considers that it is not open to a taxpayer to choose for them to be treated as separate assets. As recognised by Fitzgerald J in the appeal in the *Tully Sugar Milling* case, a unit of property for the purposes of the legislation under consideration in that case had to be capable of independent existence (see 83 ATC 4495 at 4506).
4.	**Determination of effective life** (i) Determination of effective life should correspond to the estimate useful life of the pit as it exists at the time the determination is being made, for example, if the effective life of the starter pit is being ascertained this would correspond to the period for which the features of the starter pit are intended to be used, rather than the life of the mine. (ii) Confirm that it is necessary to identify the relevant mine and then estimate the effective life of that mine – not simply the remaining term of the mining lease.	**Disagree.** The ATO view is the pit endures, notwithstanding it is constantly being widened and deepened such that the size of the pit enlarges over time. It follows that the effective life of an enduring pit would equate to the remaining useful life of that pit, rather than equate to some lesser period by reference to the structural features of the pit that exist at the time the assessment of effective life is being made.

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4. cont	(iii) A re-estimation of effective life is allowed under section 40-110 of the ITAA 1997 and it is mandatory to do so where the cost of the asset increases by 10% in an income year.	In respect of (iii) a new paragraph 37 has been inserted into the Ruling noting that a miner is able to recalculate the effective life of a pit should the nature of the use of the pit change, for example, a change to the mine plan.
5.	**Split asset and balancing adjustment provisions** The Ruling needs to discuss the split asset provisions and consequent balancing adjustments. If you stop holding part of a depreciating asset the UCA provisions apply as if just before you stop holding that part you split the original asset into the part you stopped holding and the remainder of the original asset. A balancing adjustment event will occur in respect of that part of the asset ceased to be held by reference to the proportion of the adjustable cost attributable to that asset. In the case of an open pit, a deduction equal to this proportion of cost will arise (as there are no proceeds where a depreciating asset is destroyed). The process of 'pushing-back' falls within the operation of section 40-115 of the ITAA 1997 such that there is a split of the open pit depreciating asset into the part of the pit that remains and the part of the pit that ceases to be held by the taxpayer by virtue of its destruction.	**Disagree that the split asset provisions apply** New paragraphs 45 and 46 inserted into the Ruling providing the view that the split asset provisions do not trigger as a result of the pushback process. Subsection 40-115(2) of the ITAA 1997 is the provision that could potentially apply to treat the part of the pit obliterated as being split from the rest of the pit. Such a split would trigger a balancing adjustment event deduction referable to the cost of the obliterated part. The ATO view is that subsection 40-115(2) of the ITAA 1997 does not apply as the pushback process is more correctly viewed as altering the profile of an existing depreciating asset – something that occurs as the pit enlarges to enable the underlying mineral deposit to be mined out.
6.	**Market valuation comments** Query whether these comments are more appropriate for a practice statement rather than a public ruling.	**Disagree** Normally market valuation commentary is not provided in public rulings. However, it was considered worthwhile in this instance to provide some comment given the establishment of a market value for a pit presents a unique challenge as pits are not actively traded assets and their value is closely linked to the market value of the associated mining right. It is also noted that these comments are provided in the Explanation.

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7.	**Interaction between TR 95/36 and TR 2012/D3 should be explained in further detail** • expenditure incurred in the working or extraction of the ore body is deductible as a revenue expense, including haulage roads constructed over the ore body; • capital expenditure will generally only arise in open pit mines having a life in excess of two years.	**Disagree** That there is an interaction between TR 95/36 and TR 2012/D3 and is noted at paragraph 40 of the Ruling.
8.	**The depreciating asset will not be taxable Australian real property for the purposes of section 855-10 of the ITAA 1997** While the mining lease will be taxable Australian real property the open pit depreciating asset will not be a separate CGT asset that requires a separate valuation for the purposes of determining the market value of taxable Australian real property.	**Disagree** The Ruling deals with the capital allowance treatment of open pit mine site improvements. The scope of the Ruling has not been expanded to include a view on the operation of Division 855 of the ITAA 1997.
9.	**Start time** Latter part of paragraph 158 is confusing in describing when the pit first exists as a depreciating asset. The start time should occur when construction commences as opposed to when various components 'begin to take shape'. Paragraph should be reworded or deleted in order to remove any confusion.	**Disagree** A tangible depreciating asset must be capable of being put to use. The difficulty with an open cut pit is that its construction and use are one and the same. The Ruling attempts to address this peculiarity by providing (at paragraph 30) that the start time happens when it becomes necessary to use the pit to further its own construction or to extract mineralised rock. In practice, the start time is likely to be some time soon after the hard rock has been reached (for example, vegetation and top soil removed) and the drill and blast method of excavation of that hard rock has commenced.
10.	**Editorial paragraphs** Paragraphs 62-63 are editorial in nature and not relevant to the findings in the ruling; nor are they entirely accurate. These paragraphs should be deleted.	**Agree** Paragraphs have been deleted.

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11.	**Status of examples** Examples are not operative (as stated at paragraph 125 of the draft Ruling) nor has the recent amendment to section 15AD of the *Acts Interpretation Act 1901* strengthened the status of examples.	**Partially agree** Discussion of the status of examples in the Explanation has been revised.