IT 153 - Repairs and improvements effected concurrently

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TAXATION RULING NO. IT 153

REPAIRS AND IMPROVEMENTS EFFECTED CONCURRENTLY

F.O.I. EMBARGO: May be released

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PREAMBLE As a result of three Board of Review decisions concerning the situation where repairs and improvements had been carried out contemporaneously, advice issued to Branch Offices setting out guidelines to be followed in such cases.

RULING 2. In dealing with claims arising under sections 51 and 53, it will be necessary to have regard to three decisions of the Boards of Review. These cases were concerned mainly with the use of a different material from that used in the original construction of a building and the extent to which deductions should be allowed where the basic structure of a building remains unchanged but substantial alterations and improvements are effected in order to give the building a modern appearance.

3. In the first case, 14 CTBR(NS) Case 40; 18 TBRD Case T75, a bitumen floor laid on a gravel base was replaced by a new floor consisting of an underlay of concrete topped with granolithic and Board of Review No.2 held that the expenditure in question was an allowable deduction under section 51.

4. As pointed out in a previous memorandum concerning that case, the selection of a different kind of material from that previously in use is not sufficient of itself to prevent the allowance of a deduction, Similarly, the use of a different material which happens to be more expensive than the material being replaced is not decisive. It now seems clear that, where restoration of part only of a building such as a floor is involved and the new floor is not obviously superior in quality to the old, a Board would be likely to take a broad view of the matter and not draw any fine distinctions in determining whether part of the outgoing constituted an improvement.

5. In the second case, the taxpayer derived rent as owner of a hotel and the relevant claim before Board of Review No.1 was concerned with various kinds of electrical work which the taxpayer was obliged to have done by direction of a licensing court. As the questions at issue were considered to be entirely factual, the Board was not asked to give written reasons for its decision and it is not possible therefore to indicate precisely

the grounds on which the claim was allowed in part.

6. The Board allowed as a deduction the cost of rewiring and repositioning existing light outlets but disallowed the expenditure applicable to new mains and switchboards, sub-mains and new power points. Although the segment of the work allowed as repairs appeared to be an integral part of a new and improved electrical system, the Board was evidently prepared to examine separately the several items comprising the contract and determine whether each individual item was a repair or an improvement, rather than to look to the end result of the entirety of the work done. In other words, where individual parts of the work done are capable of being classified as repairs if examined in isolation from the remainder of the contract, the Board would be prepared to accept those items as repairs if the cost can be reasonably quantified.

7. A similar approach was taken by Board of Review No.3 in another case, 14 CTBR(NS)Case 54; 18 TBRD T44. In this case the entirety of the property consisted of a block of five shops on which a substantial amount of renovations and improvements was carried out. The total expenditure amounted to $49,116 of which $13,374, representing twenty-two individual items, was argued before the Board as being deductible under section 53.

8. The Board's attitude to the matter is conveniently summarised in paragraph 6 of the reasons of the Acting Chairman which reads as follows:-

> "'Repair' involves the restoration by renewal or replacement of a subsidiary part of the whole, to bring it to the condition that it formerly had, without changing its character: (W. Thomas & Co. v Commissioner, 14 ATD at p.87 and Lurcott v Wakely & Wheeler (1911) 1 KB at p.923). If the work done goes beyond mere repair, as described, and results in substantially a new and improved structure or thing, the whole cost of the improvement is a capital charge. In such a case, the taxpayer shall not have even the benefit of 'notional repairs', i.e., the amount which it is estimated that it would have cost the taxpayer if (contrary to the fact) he had been contented with mere repair: (The Western Suburbs Cinema (1952) 86 CLR 102). Nevertheless, repairs do not necessarily change their character merely because they are carried on contemporaneously with improvements: (10 CTBR(OS) Case 83; 5 CTBR(NS) Case 9). In that event, if the taxpayer is to succeed qua repairs he must be capable of proving, on the facts, that it can be found possible to segregate the cost of repairs actually effected, which are chargeable against income, from the (capital) cost of improvements actually effected: (The Western Suburbs Cinema Case (supra) at p.108 with particular reference to Highland Railway Co. v Balderston (1889) 2 TC 485). Finally, the substitution of modern equivalents in materials is not necessarily to be regarded as an improvement in

lieu of a repair: (Wates v Rowland (1952) 1 All ER 470; and Morcom v Campbell-Johnson ((1955) 3 All ER 264)."

9. The Board then proceeded to examine the twenty-two individual items claimed as repairs and allowed deductions in thirteen instances. Consistently with the High Court decision in the Western Suburbs Cinema Case, the Board disallowed claims based on notional amounts of expenditure that would have been incurred if the taxpayer had in fact effected a repair to the items in question. Where, however, the work done to the unit of property was a 'repair', a deduction was allowed of the amount applicable to that unit and, in this regard, an apportionment based on actual expenditure which could reasonably be attributed to the particular item was accepted.

10. The decisions discussed are regarded as supporting the broad proposition that, where extensive renovations and improvements are undertaken, the Boards would be prepared to examine individual parts of the total project to determine whether any such part, if examined in isolation from the entirety, would fall within the category of a repair. It will, of course, remain a question of fact whether the individual item on which the claim is based is a repair or an improvement but, where a substantial work of modernisation is undertaken, it will not be possible to rely on the argument that the project should be regarded in its entirety as an affair of capital.

COMMISSIONER OF TAXATION