IT 333 - Expenditure on spare parts and consumable stores. Whether deduction allowable on usage basis or in year of purchase

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There is an Addendum (1) notice for this document.

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TAXATION RULING NO. IT 333

EXPENDITURE ON SPARE PARTS AND CONSUMABLE STORES. WHETHER DEDUCTION ALLOWABLE ON USAGE BASIS OR IN YEAR OF PURCHASE

F.O.I. EMBARGO: May be released

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PREAMBLE The question has arisen of what deductions should be allowed to taxpayers for expenditure incurred on spare parts and consumable stores where the taxpayers have hitherto deducted expenditure on these items in the year the parts or stores were used and now wish to change to an expenditure incurred basis.

2. The matter has come to notice because a number of companies have sought in the year of change-over to deduct not only expenditure incurred on spare parts and consumable stores in the year of change-over but also the balance of expenditure undeducted on spare parts and consumable stores which were on hand at the close of the preceding income year. To allow the deductions as claimed would have a significant effect on revenue collections in the year of change.

3. This Office previously examined a reference to a Board of Review involving the correct treatment for income tax purposes of expenditure on spare parts for repairing plant, motor vehicles, etc. In the particular case the available evidence indicated that the taxpayer purchased sufficient spare parts to ensure that production was not interrupted. There was no suggestion that a store of spare parts was being built up. In fact the cost of plant and equipment on hand at the end of the year of income was to the order of $2.2m, whereas the estimated value of spare parts on hand was $12,500.

4. In the circumstances it was decided that a deduction should be allowed for the cost of spare parts in the year of income in which they were purchased. Deputy Commissioners were advised that the decision could be applied in other situations where it was established, having regard to the nature of the business carried on, that spare parts were purchased in quantities sufficient to enable the business to be carried on efficiently. The position would need to be reconsidered in a case where a substantial quantity of spare parts in excess of normal requirements was being built up.

5. In the present case the taxpayer claimed deductions for spare parts, refractories, stores and other consumables. Information supplied by the taxpayer revealed that the average life of spare parts was to the order of 2 years, refractories 9 months and stores and other consumables 3 months.

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6. Bearing in mind the average life of spare parts it has been decided that the expenditure involved was directed more towards building up a store of spare parts rather than providing for the immediate requirements of the company. In the circumstances it has been decided that deductions for spare parts should continue to be allowed on a usage basis. Although the question was not so clear cut as regards refractories it was decided that deductions for this item should also be on a usage basis.

7. The stores and other consumables were in a different category. Stores were made up of a miscellany of small items while other consumables included fuel oils, etc. Because the average life of both categories was 3 months it has been decided that section 51 would authorise a deduction for expenditure incurred in a year even though some of the items may be on hand and unused at the end of the year.

8. The circumstances of this case may be used as a guideline in determining whether a taxpayer should be permitted to change to an incurred basis.

9. Where permission is given to change to an incurred basis there will be an undeducted amount of expenditure on spares and stores on hand at the beginning of the year of change. It is accepted that, if the taxpayer so requested, assessments issued within 3 years of the date of request could be amended to allow deductions on the incurred basis. In all probability, however, this would leave some amount of expenditure undeducted, i.e. the opening balance in the earliest of the years capable of amendment.

10. By way of alternative it is considered that a deduction for the opening balance could continue to be allowed on a usage basis. As a practical matter this would involve allowing a deduction for the opening balance over the year of change and 1 or 2 more years depending upon the amount of the opening balance and the average life of the spare parts, etc. involved. The opening balance should not be allowed as a deduction in the year of change unless it is of a relatively insignificant amount. In the particular case referred to above it was decided that the opening balance of expenditure on stores and other consumables should be allowed as a deduction over 2 years, i.e. the year of change-over and the succeeding year.

11. The above principles do not apply to spare parts which are termed rotable, cyclic or insurance spares in the aviation industry or standby and other spares that are alternate parts for particular units of plant. The cost of these spares may properly be accepted as part of the cost of the units to which they relate for depreciation purposes.

COMMISSIONER OF TAXATION