LCR 2021/3EC - Compendium

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Australian Government
Australian Taxation Office

Public advice and guidance compendium – LCR 2021/3

Relying on this Compendium

This Compendium of comments provides responses to comments received on draft Law Companion Ruling LCR 2021/D1 *Temporary full expensing*. It is not a publication that has been approved to allow you to rely on it for any purpose and is not intended to provide you with advice or guidance, nor does it set out the ATO's general administrative practice. Therefore, this Compendium does not provide protection from primary tax, penalties or interest for any taxpayer that purports to rely on any views expressed in it.

Summary of issues raised and responses

Issue number	Issue raised	ATO response
Choosing not to apply temporary full expensing		
1	What would the Commissioner's position be where a taxpayer had initially self-determined that they were not entitled to the temporary full expensing (TFE) concession and accordingly lodged the income tax return with a depreciation claim in the normal manner (that is, no opt-out choice was made as it was considered that the assets were not eligible for TFE)? However, later the taxpayer discovers the relevant assets were in fact eligible for the TFE measure. Would the Commissioner allow the choice to opt out to be made at a later time, or would it be expected that the assessment be amended to make the TFE claim, or would the Commissioner not apply compliance resources to those taxpayers who did not actually make a claim for TFE?	When it is determined that assets are eligible for TFE post-assessment, it is expected that the assessment would be amended to give effect to that entitlement. If opt out is sought, the final Ruling notes (at the footnote to paragraph 87) that the ATO may defer the time for giving the choice if not given by the date of lodgment. Whether deferral is granted will depend on the particular circumstances. We have outlined a compliance approach for the opt-out choice, applicable in certain circumstances, on our website. If further practical guidance on opt out becomes necessary, it would likely be provided as a website update.
Assets without the relevant connection to Australia		
2	Confirm that when working out the attributable income of a controlled foreign company, the TFE measure would be unlikely to apply due to the requirement that	Footnote 40 in paragraph 44 of the final Ruling has been added to highlight that TFE is not likely to be relevant when working out attributable income.

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	the asset be used principally in Australia for the principal purpose of carrying on a business and that it be located in Australia.	
3	Confirm the application of the term 'principally'; for example, is this based on the asset's expected effective life and whether it is expected to be in Australia for a certain proportion (for example, greater than 50%) of that life? In the case of mobile assets (such as plans or boats), is it based on proportion of actual use?	Paragraphs 44 to 46 have been added to the final Ruling to further explain the 'principal use in Australia' test.
Low-value pool exclusion		
4	Although paragraph 44 of the draft Ruling outlines that low-cost assets (costing less than $1,000) are not eligible for TFE where the entity has an existing low-value pool under Subdivision 40-E of the *Income Tax Assessment Act 1997* (ITAA 1997), it would be useful to highlight that such assets may be eligible for the instant asset write-off under section 40-82 of the ITAA 1997 (if the relevant criteria under that section are met).	Footnote 43 in paragraph 47 of the final Ruling has been added to make this point.
In-house software pools exclusion		
5	Clarify whether a taxpayer who has chosen at any time in the past to allocate an amount of expenditure to a software development pool will not be able to apply TFE to any subsequent in-house software asset that has been developed by or commissioned for the taxpayer. An example would be helpful.	Paragraph 48 of the final Ruling has been amended to make this point more clearly.
Clarification on the pre-existing commitments exclusion		
6	The Commissioner should provide examples on demonstrating eligibility in each of the three scenarios set out under section 40-165(2) of the *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A).	Some further explanation of the statutory concepts has been provided in paragraphs 52 to 57 of the final Ruling. Where these provisions are relevant for a taxpayer, it is considered that the outcome will depend on the particular facts, circumstances and terms of contracts and

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		construction arrangements. It is not considered that additional examples would substantially assist in illustrating interpretive views or providing answers for common fact patterns.
7	Can the ATO address how the exclusion applies in respect of pre-existing contracts (entered into before 6 October 2020), which contained pre-determined stages or milestones whereby a decision to proceed to the next stage is made at a later point in time after 6 October 2020? For example, long-term infrastructure projects undertaken in various stages where the commencement of each stage is dependent on the completion of the previous stage and a decision to proceed by the parties. Would the Commissioner take a view that TFE is available in respect of any relevant depreciating assets (which would otherwise be eligible) on the basis that a contract under which the taxpayer would hold the later stage assets is not effectively entered into until the taxpayer has made a decision to undertake subsequent stages of the project after 6 October 2020?	The answer to the question in each case will depend on identifying the relevant depreciating assets and construing the terms of the particular contract. Some further explanation has been added in paragraph 53 of the final Ruling.
8	The draft Ruling does not provide guidance in relation to what 'started to construct the asset' means other than referring to section 165(4) of the IT(TP)A which provides that you 'treat yourself as having started to construct an asset at the time you first incur expenditure in respect of the construction of the asset at that time'. The term 'started to construct the asset' has been used before and considered in the guidance and example in paragraphs 1.107 and 1.108 of the Explanatory Memorandum to the Tax Laws Amendment (Small Business and General Business Tax Break) Bill 2009, which provided a similar	Additional guidance on 'started to construct the asset' has been provided in paragraphs 54 and 55 of the final Ruling.

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	additional deduction for certain new business investment in 2009. This guidance indicates that the intention is that construction of the asset is not considered to be started until a decision has been made to proceed with the construction and orders are made for the materials needed. Therefore, certain costs incurred prior to 6 October 2020 may not cause a new asset to be ineligible provided that the decision to proceed with construction occurred post 6 October 2020. The Commissioner should clarify this in the final Ruling to provide more certainty to taxpayers.	
9	Is there a distinction to be made between self-constructed assets and third-party commissioned contracted construction? That is, is the relevant date where the taxpayer entered into the contract for the third party to construct the asset (under paragraph 40-165(2)(a) of the IT(TP)A) or where the taxpayer first incurred expenditure in relation to the construction (under paragraph 40-165(2)(b) and subsection 40-165(4) of the IT(TP)A)?	Paragraph 54 of the final Ruling provides further explanation.
10	The final Ruling should confirm that 'construction' of an asset would include software development expenditure and associated internal labour costs that are capitalised into a software development asset in circumstances where a taxpayer has not elected to allocate such software development expenditure to a software development pool (which would be excluded from TFE under subsection 40-150(4) of the IT(TP)A).	Paragraph 56 of the final Ruling has been added to express the view that expenditure in respect of an asset's construction would cover expenditure on the development of in-house software when no choice has been made to allocate expenditure of this kind to a software development pool.
11	The deeming of a partner's actions in relation to a partnership as referred to in section 40-165(6) of the IT(TP)A is important and should not be omitted from the final Ruling.	Footnote 47 has been added to paragraph 51 of the final Ruling to explain that a partner's actions are deemed to be those of the relevant partnership for the purpose of the pre-existing commitments exclusion.

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12	Clarify that the pre-commitment time is not relevant to second-element costs that would otherwise qualify under section 40-170 of the IT(TP)A.	This point is made in paragraph 77 and Example 6 of the final Ruling.
13	A scenario involving a member of a consolidated group who sells an asset (held as trading stock) to another member of the group who holds as a depreciating asset raises a general question about the time of holding a depreciating asset for TFE eligibility purposes. The question is whether an asset held as trading stock before 2020 Budget Time that starts to be held by the same entity as a depreciating asset after that time is eligible for TFE.	Paragraph 57 has been added to the final Ruling to address this scenario.
Capitalised labour		
14	It would be useful if the Commissioner could clarify that, to the extent labour costs are capitalised into depreciating assets on the basis that they are incurred in relation to the construction or creation of depreciating assets (that otherwise satisfy the eligibility requirements for TFE), these capitalised labour costs should be eligible for full expensing.	The issue does not relate to the operation of the TFE rules but, rather, to the ordinary rules for determining cost of a depreciating asset. Further explanation of depreciation cost rules is not considered necessary for the purposes of this Ruling.
Second-hand assets exclusion		
15	It would be useful for further guidance or examples on the concepts of when a depreciating asset might have been acquired from another entity that had merely used it for the purposes of reasonable testing or trialling.	We have not identified interpretive issues with the concept of 'reasonable testing or trialling'. We will consider providing further guidance if these issues emerge.
16	A further example would be useful to demonstrate the ATO's views where a 'new' depreciating asset has been purchased from another entity that has constructed or refreshed the asset out of new materials or parts in conjunction with old parts or elements of a previously existing depreciating asset.	The question of whether a depreciating asset is a new asset or an existing asset that has been repaired/refreshed will depend on the facts. We consider that a further example in the final Ruling would not provide sufficiently useful general guidance.

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17	It would be useful to reinforce the point made in Example 9 that notes that the second-hand asset exclusion does not apply to second-element costs.	This point has been made in paragraphs 50 and 77 of the final Ruling.
18	An example highlighting the difference in treatment of second-element costs that are incurred in the same year of first use (deductible under section 40-160 of the IT(TP)A) versus a later year (deductible under section 40-170 of the IT(TP)A) would be useful.	We consider that existing Examples 4, 5 and 6 of the final Ruling are sufficient to illustrate relevant principles.
Composite items		
19	The ATO's views in relation to the treatment of a particular expense in relation to an asset as an improvement/second-element cost or a separately identifiable depreciating asset is particularly important when determining eligibility under the TFE rules. Recommend that the ATO progress to finalise its views in addressing the issues noted in Draft Taxation Ruling TR 2017/D1 *Income tax: composite items and identifying the depreciating asset for the purposes of working out capital allowances* and make reference to this issue in the final Ruling.	We agree that the issues in TR 2017/D1 are important for TFE treatment. We will progress to finalisation of its views (refer to the Advice Under Development Program for status updates).
Balancing adjustment events		
20	It is noted that a balancing adjustment event under subsection 40-295(2) of the ITAA 1997 can apply where there is a minor change in the interest held in a partnership asset (for example, a 1% partner exits the partnership). Even though there may be rollover relief under subsection 40-340(4) of the ITAA 1997, the balancing adjustment event nevertheless is deemed to have occurred. It is recommended that the final Ruling contain an example to highlight this outcome which may not otherwise be commonly known to taxpayers.	Changes have been made, including a new Example 7 in paragraphs 92 to 94 of the final Ruling, to illustrate the effect of the balancing adjustment event under subsection 40-295(2) of the ITAA 1997 on eligibility for TFE.

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21	In relation to non-taxable use, the draft Ruling does not expressly explain: • how the non-taxable use of a depreciating asset in the year the asset qualifies for TFE affects that calculation of the deduction, and • how the non-taxable use of a depreciating asset in a later income year affects the calculation of the balancing adjustment amount.	Additional wording has been added to paragraph 73 of the final Ruling to clarify how a deduction based on TFE is reduced to the extent of non-taxable use. Additional text and a further Example 8 have been included at paragraphs 95 and 96 of the final Ruling to explain how non-taxable use in a year after the TFE claim year will not reduce balancing adjustment amounts for balancing adjustment events in years after the claim year.
Interaction with instant asset write-off and backing business investment		
22	Regarding Example 9 of the draft Ruling: • In respect of the $25,000 improvement cost for Asset B, it would be useful for the example to expressly state that the opt out of TFE may be available for the $25,000 second-element costs and instant asset write-off (IAWO) may or may not apply, depending on whether the IAWO provisions applied to the initial acquisition (first-element costs) of the asset. • It is recommended the ATO provide greater clarity to taxpayers beyond 30 June balancing entities (that is, those with substituted accounting periods) on the application of the rules, including the various acquisition and first-held dates for these taxpayers.	A change has been made to Example 11 (formerly Example 9) of the final Ruling to highlight that 'opt out' of TFE can apply for second-element costs and that IAWO will not apply on the facts of the example because the cost exceeds the relevant threshold. Example 11 of the final Ruling has not been expanded to include the circumstances of an entity with a substituted accounting period. It would add unnecessary complexity to the facts of the example without substantial further illustration of the principles. If specific issues start to emerge in relation to entities with substituted accounting periods, we will consider providing further guidance at that time.
23	The final Ruling should expressly delineate between the IAWO available to medium and larger businesses from 2 April 2019 (section 40-82 of the ITAA 1997) and the original temporary increased IAWO under the simplified depreciation rules for small business entities that has been available since 12 May 2015 (section 328-180 of the ITAA 1997), with varying thresholds applicable in different periods, and reverted	Paragraph 142 of the final Ruling has been added to highlight how IAWO applies specifically to small business entities using simplified depreciation.

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	to $1,000 from 1 January 2021.	
24	Paragraph 109 of the draft Ruling should be amended in the final Ruling to state the IAWO rules applied with effect from 7.30pm (AEDT) on 2 April 2019.	The effective date for section 40-82 of the ITAA 1997 was 1 July 2019. Paragraph 127 of the final Ruling now refers to 2 April 2019 as the relevant date for asset eligibility.
Small business entities – car limit		
25	Paragraph 127 of the draft Ruling provides that the car limit in section 40-230 of the ITAA 1997 may apply to determine the maximum cost that can be deducted under the simplified depreciation rules. It is recommended that the final Ruling refer to the issue of the car limit earlier within its contents to appropriately address its relevance to all taxpayers who acquire cars more broadly (that is, the car limit also applies to limit the amount of the IAWO, backing business investment and TFE for non-small business entity taxpayers).	Paragraph 73 has been added to the final Ruling to explain how the 'cost' of an asset is the basis for determining decline in value under TFE and how that cost may be adjusted in accordance with the car limit.
26	Consider including a direct reference to the car limit for the 2021–22 income year of $60,733 (while retaining the inclusion of the amount of the car limit for the 2020–21 year).	Footnote 120 has been included in paragraph 153 of the final Ruling, specifying the car limit for the 2021–22 income year.
27	Consider explaining that, even if the actual price paid for the car exceeds $150,000, the car could still be eligible for IAWO as the deemed cost in section 40-230 of the ITAA 1997 overrides the actual cost.	No further change is considered necessary. The application of the car limit in the context of the IAWO is explained in existing ATO web guidance.
Small business entity – example		
28	Example 10 of the draft Ruling could be improved by further illustration of how TFE applies to a general small business pool balance for a taxpayer choosing to use simplified depreciation rules in circumstances where those rules were not available to, or not chosen by, the taxpayer in the previous year.	Changes have been made to Example 12 (formerly Example 10) of the final Ruling to further explain the application of TFE to a general small business pool in the circumstances raised by the submission.

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29	The ATO may wish to clarify that, by operation of the law, if a small business entity chooses to continue to apply the simplified depreciation rules, they are required to fully deduct their general small business pool balances on 30 June 2021 and cannot choose not to deduct the pool balance.	An additional sentence has been added to paragraph 150 of the final Ruling to clarify the requirement to deduct a pool balance.
Interaction with the research and development provisions		
30	There should be acknowledgement that since TFE deductions occur under section 40-25 of the ITAA 1997, these decline in value deductions can be included (where appropriate) in eligible research and development (R&D) expenditure due to the overlay of sections 355-305 and 355-310 of the ITAA 1997. There should at least be a brief commentary on the interaction, given the extension of the TFE rules to 30 June 2023.	Paragraphs 138 and 139 have been added to Part E of the final Ruling to explain the relevance of TFE for the notional decline in value deduction under the R&D tax offset rules.
31	This would be a valuable opportunity to raise the issue of the increased risks that will result where R&D assets are disposed of in the future, with the necessity to increase balancing adjustment amounts where declines in value have been included in eligible R&D expenditure over the effective life.	The final Ruling relates to the operation of the TFE provisions. While it is appropriate to explain the relevance of TFE for the R&D tax offset rules, this further suggested change goes beyond the subject matter and scope of the Ruling and would add to its length. No further change is considered necessary.
Assets acquired by associates		
32	There are provisions in Division 40 of the ITAA 1997 that require an entity to adopt the effective life and depreciation method of the transferor, namely subsections 40-65(2) and 40-95(4) of the ITAA 1997 for assets acquired from associates. It would be useful if the final Ruling provided clarification that TFE is available for assets acquired from associates due to the primacy of Subdivision 40-BB of the IT(TP)A. It would also be helpful if the final Ruling could consider whether the IAWO could apply in priority to	Paragraphs 62 and 63 have been added to the final Ruling to clarify that subsections 40-65(2) and 40-95(4) of the ITAA 1997 are not applicable if an entity is eligible to apply TFE under Subdivision 40-BB of the IT(TP)A or IAWO under section 40-82 of the ITAA 1997. Paragraph 63 of the final Ruling notes, however, that the ATO may scrutinise certain arrangements where immediate write-off is obtained for assets acquired from associates.

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	subsections 40-65(2) and 40-95(4) of the ITAA 1997 where assets are acquired from associates.	
Interaction with the tax consolidation provisions		
33	Application of the alternative income test to the head company: • Disagree with the Commissioner's draft position that a joining entity's 'pre-joining time' acquisition and holding history is not inherited by the head company for the purposes of the second condition of the alternative income test because of the operation of the tax cost-setting process and subsection 705-55(2) of the ITAA 1997. • Although an interpretation involving the entry history rule may result in double-counting, from a policy perspective, the intention of the alternative income test conditions was to ensure that eligible entities have a track record of making substantial investments in Australia. Therefore, it is suggested that a reasonable interpretation be adopted.	An alternative view has been considered having regard to submissions received on this issue. However, it is considered that the view expressed in the draft Ruling is the better view of the law and is consistent with the purpose of the second condition of the alternative test for TFE eligibility. Accordingly, no changes have been made to the relevant paragraphs of the final Ruling.
34	It is recommended that the final Ruling should address whether the IAWO (which can apply to second-hand assets) prevails over subparagraphs 701-55(2)(b) to (e) of the ITAA 1997, despite no express provision (as opposed to the clear priority rule under TFE) so that a head company can access the IAWO for assets that are brought into a consolidated group through a joining event.	Paragraph 116 of the final Ruling addresses this issue.
35	The draft Ruling does not provide substantial guidance on aggregated turnover computations in the context of tax consolidated groups, particularly when entities join or leave groups. Part D of the final Ruling should be	We agree that there can be complexity in the determination of aggregated turnover when entities join and leave consolidated groups. There are also discrete issues to be considered depending on whether it is a head company, joining entity or leaving entity seeking to establish eligibility for TFE.

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	expanded to cover the calculation of aggregated turnover under joining and leaving scenarios, as well as the calculation of income for the purposes of the alternative income test under similar scenarios.	While these issues are important, dealing with them in the final Ruling would add considerable length and complexity to the product. They also involve matters on which further consultation may be required. As the primary purpose of the Ruling was to provide guidance on the operation of the substantive TFE rules for all business entities, including small business, it is considered preferable to finalise the Ruling and deal with the effect of tax consolidation on aggregated turnover calculations separately.