PS LA 2003/8 - Taxation treatment of expenditure on low cost items for taxpayers carrying on a business.

ATO Practice Statement
Law Administration

PS LA 2003/8

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FOI status: may be released

This Practice Statement is issued under the authority of the Commissioner and must be read in conjunction with Law Administration Practice Statement PS LA 1998/1. It must be followed by tax officers unless doing so creates unintended consequences. Where this occurs tax officers must follow their Business Line's escalation process.

SUBJECT: **Taxation treatment of expenditure on low cost items for taxpayers carrying on a business.**

PURPOSE: **To provide guidance on:**

- **a threshold rule for dealing with expenditure on low cost items; and**
- **a sampling rule for estimating the revenue expenditure component of bulk purchases based on sampling.**

BACKGROUND

1. This Practice Statement provides guidance on two straightforward methods that taxpayers carrying on a business can use to help them determine if expenditure incurred by them to acquire certain low cost tangible assets is to be treated as on revenue account or capital account.

2. These approaches may be used by taxpayers in assisting them to demonstrate practical compliance while reducing the need to undertake onerous analysis of records. If applied as detailed in this Practice Statement to the relevant expenditure these methods will be accepted by tax officers.

3. Determining whether expenditure is revenue or capital in nature is one of the legislative requirements for working out whether it is either immediately deductible under section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997) or written-off under the capital allowance rules in Division 40 of that Act. This Practice Statement is designed to set down reasonable administrative mechanisms for establishing the character of the expenditure. It does not ignore the legislative requirements but rather provides a reasonable means of determining whether those requirements are met, in a way that balances the costs of compliance against the need for integrity in the system.

GENERAL QUALIFICATIONS

4. This Practice Statement does *not* apply to expenditure incurred by a taxpayer on:

- establishing a business or business venture or building-up a significant store or stockpile of assets;
- assets held by the taxpayer under a lease, hire purchase or similar arrangement;
- assets acquired by the taxpayer for lease or hire to, or that will otherwise be used by, another entity;
- assets included in an asset register maintained by the taxpayer in a manner consistent with reporting requirements under generally accepted Australian accounting standards;
- any asset that forms part of a collection of assets that is dealt with commercially as a collection (e.g. by being sold and leased-back as a means of raising finance for the business);
- trading stock or spare parts.

5. This Practice Statement does not apply separately to expenditure on items that are part of another composite asset (in this case, expenditure on the composite asset must be tested). Items would not normally be a separate asset where they are not functional on their own (e.g. scaffolding clamps).

6. This Practice Statement also does not apply to expenditure incurred by businesses that had entered the former simplified tax system prior to 1 July 2007 or satisfy the definition of a small business entity from 1 July 2007 and are using the simplified depreciation rules – as these businesses are able to claim an immediate deduction for expenditure on assets costing less than $1,000.

7. Record retention requirements are not changed by this Practice Statement as the taxpayer must continue to retain all relevant records as required under the income tax and other taxation laws.

STATEMENT

8. The threshold rule and sampling rule have been developed to lessen the cost of accounting for low cost items. They cover expenditure below a threshold and the use of statistical sampling to estimate total revenue expenditure on low cost items.

Threshold rule

9. Expenditure of $100 or less incurred by a taxpayer to acquire a tangible asset in the ordinary course of carrying on a business can be assumed to be revenue in nature for income tax purposes if this Practice Statement applies to the expenditure. This expenditure is inclusive of any GST included in the price of the item ensuring there is no need to separately identify any GST applicable to individual items[1].

Examples

[1] Note, however, that Division 27 of the ITAA 1997 ensures that a deduction is not available for expenditure to the extent it relates to an input tax credit or decreasing adjustment under the GST legislation.

10. Some examples of low cost items that fall within the threshold rule, subject to the qualifications in paragraphs 4 to 7, are:

- office equipment costing $100 or less including hand held staplers, hole punches, manila folders, ring binders, geometry sets, stencils, calculators, tape dispensers, scissors, labelling machines, document holders, and bar coding machines;

- catering items costing $100 or less including cutlery, saucers, cups, and table linen;

- tradesperson's small hand tools costing $100 or less such as pliers, screwdrivers and hammers; and

- tools used by primary producers costing $100 or less including secateurs and pliers.

11. Some scenario examples that may help to show how the threshold rule can be applied are:

- A medium sized building maintenance business with an asset register purchases many small hand tools. All tools purchased for $100 or less that are not recorded on the asset register are claimed as outright deductions in the year of purchase.

- A small café owner, who does not maintain an asset register, purchases spoons, coffee cups, espresso glasses and saucers every few months to maintain constant levels of stock, as these items are damaged or stolen. The owner spends around $60 every 3 or 4 months for these small items and claims the whole expense as a deduction in that income year.

- A large mining business with an asset register buys a large quantity of small items each year to use in various sections of the enterprise. The items range from goggles and torches to small hand tools. These items cost $100 or less and are not recorded on the asset register. The items are claimed as business deductions in the year of purchase.

Sampling rule

12. A taxpayer with a low-value pool under Subdivision 40-E of the ITAA 1997 may use statistical sampling to determine the proportion of the total purchases on low cost tangible assets that are revenue expenditure.

13. The purchases eligible for sampling are those that are:

- purchases of items costing less than $1,000;[2] and

- not excluded by the general qualifications set out in paragraphs 4 and 5.

14. Items costing less than $1,000 are eligible as they will be allocated to the low-value pool if the expenditure on them is capital and they are depreciating assets.

[2] The 'cost' for these purposes is the cost worked out under Division 40, as that is the amount relevant for the purposes of the low-value pool. Input tax credits and decreasing adjustments under GST are normally excluded (see Division 27 of the ITAA 1997).

Accordingly, items costing $1,000 or more must be excluded for the purposes of the sampling calculations.

15. There are two options available to the taxpayer to calculate the sample.

- The first option is to extract a representative sample from the eligible purchases of an income year, and from this sample determine the percentage that is deemed to be revenue.

- The second option allows the taxpayer to choose a sample that comprises all eligible purchases for a period (e.g. two months) in an income year that is representative of the capital and revenue purchases for the business over the course of the year. From this sample the percentage that is deemed to be revenue can be determined.

16. Paragraphs 21 to 23 provide guidance on what needs to be done to ensure the sampling is ***representative***. However, as a general rule, the ATO would consider a representative sample of 10% of eligible purchases as being sufficient for purposes of the first option. Where there is a very large number of eligible purchases, a lesser percentage may also be appropriate. Similarly where there is only a limited number of eligible purchases a higher percentage may be required.

17. The sampling results can only be applied against eligible purchases (i.e. those meeting the requirements set out in paragraph 13). The revenue component is assessed for immediate deductibility under section 8-1 of the ITAA 1997 and the capital component, to the extent that it relates to depreciating assets, is dealt with according to the low-value pool provisions of Subdivision 40-E.

18. If the taxpayer's business is decentralised, so that purchases of assets evidenced in eligible purchases are made in different centres within the business, the taxpayer can perform a sampling exercise for each centre and use the results for the purchases made by that centre. This may be necessary, in order to ensure a representative sample, if the eligible purchases of the centres have different characteristics. This is more likely to be an issue for larger businesses.

19. The threshold rule can be used to assist with the revenue/capital expenditure decision for the sample.

Specific qualifications to the sampling rule

20. In addition to the general qualifications in paragraphs 4 to 7 there are some further qualifications specific to the sampling rule.

21. Statistical sampling will not be regarded as an alternative where the business' current systems result in reliable individual identification and accounting of low cost items.

22. The statistical methods employed by the business will need to be consistent with the provisions incorporated in the ATO's Audit statistical sampling guidelines which aim to ensure that the sample should be representative of the total population. Statistical sampling in accordance with this Practice Statement can be used for the

compilation of tax return information regardless of anything stated in those guidelines.

23. The sampling results must be statistically valid and result in objective, reliable and conservative estimates.

24. Statistical sampling will be acceptable if:

- all relevant records and working papers relating to the sampling are available to the ATO for examination;
- an adequate statistical sampling design has been employed;
- the sample is representative of the population from which it has been drawn;
- the data obtained from the sample are correct; and
- the estimates have been calculated correctly.

For how long can the sampling results be used?

25. The statistical sample continues to be valid for a maximum of 3 income years (including the income year in which the sampling takes place) so long as it remains representative of the total population that it is applied to. Re-sampling is required when, for example:

- there has been a significant variation in operations of business such that the composition of asset purchases could be expected to have altered;
- two businesses have merged, one of which was using the sampling rule and one of which was not;
- two businesses have merged, both using the sampling rule but having different percentages of revenue expenditure; or
- there has been a demerger of a business.

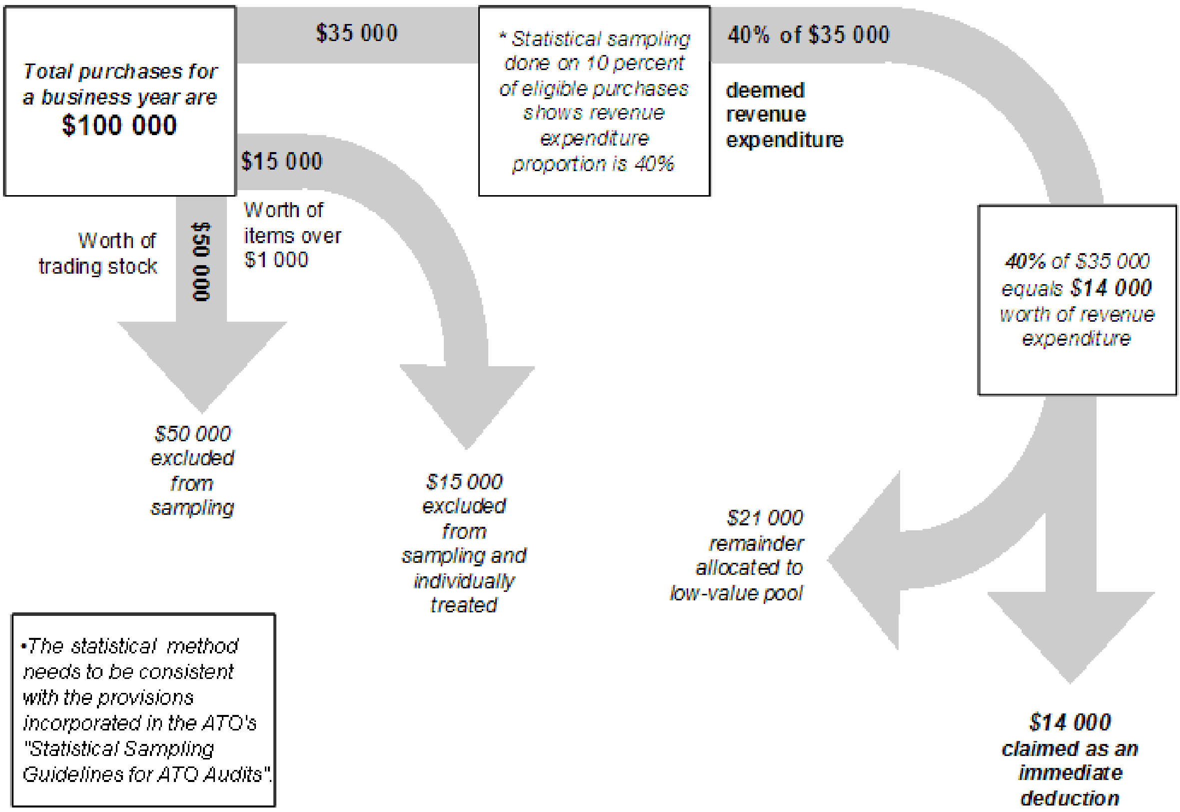
Examples

26. A small/medium business identifies $100,000 worth of purchases in an income year. These purchases include both revenue and capital items purchased in an income year.

Upon analysis, it is found that items costing $1,000 or more total $15,000 and these items are excluded for the purposes of sampling. Purchases totalling a further $50,000 are excluded from the sampling as being trading stock.

Using statistical sampling, the business identifies that 10% of items that are eligible purchases would be a representative sample for them. The result indicates that the revenue expenditure proportion is 40%.

Applying this proportion to the total value of the eligible purchases ($35,000, or $50,000 less the $15,000), the business claims an immediate deduction of $14,000 (40% of $35,000) and allocates the remaining $21,000 to the low-value pool.

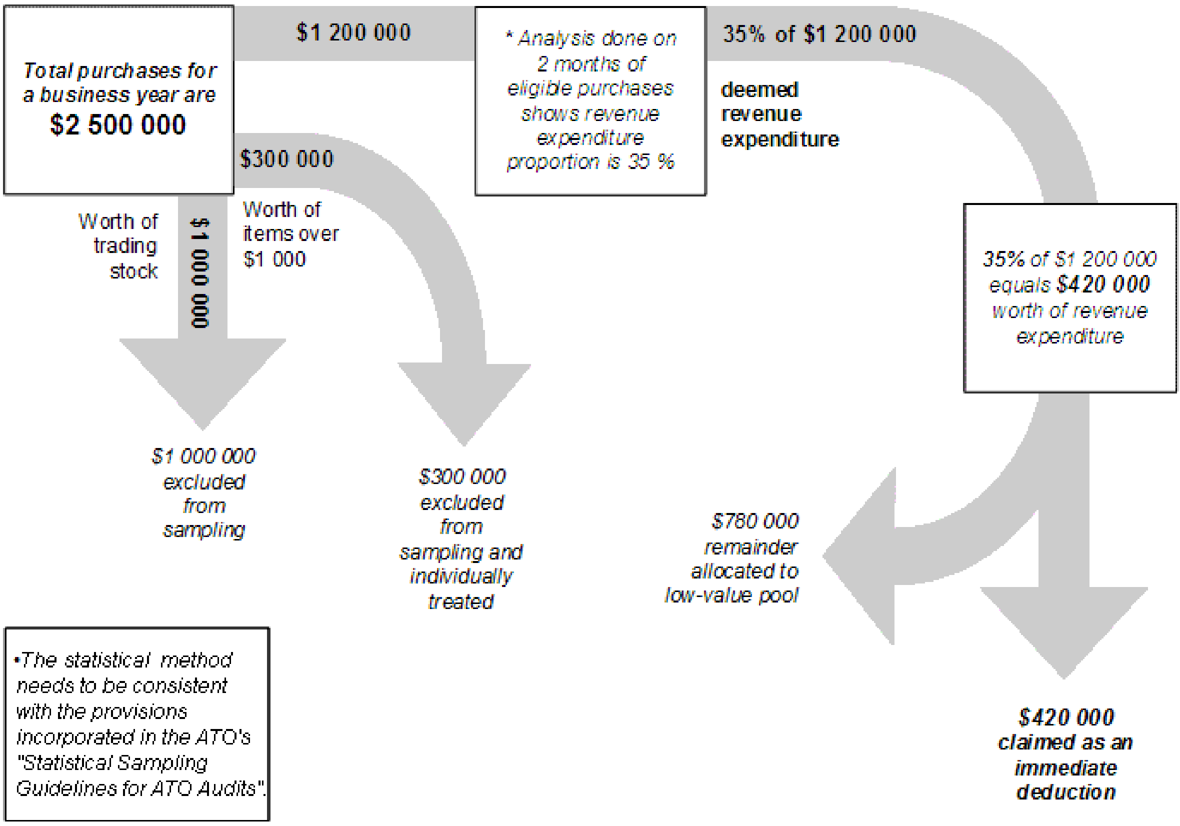


27. A large business has purchases for the income year totalling $2,500,000. Of this amount, $300,000 relates to items costing $1,000 or more. These items cannot be used for sampling. Purchases totalling a further $1,000,000 are excluded from the sampling as being trading stock.

The business identifies all eligible purchases for a representative two month period in that year.

Analysis of those eligible purchases indicates that the revenue expenditure proportion is 35%.

Applying the 35% revenue proportion for the two month sample period to the total value of eligible purchases in the income year ($1,200,000, or $2,500,000 less the $1,300,000), the business claims an immediate deduction of $420,000 (35% of $1,200,000) and allocates the remaining $780,000 to the low-value pool.



EXPLANATION

28. This Practice Statement is not about changing the way we interpret the law but about assisting tax officers when dealing with taxpayers who use simpler practical methods of demonstrating compliance with the law.

29. Expenditure incurred in carrying on a business is usually deductible under section 8-1 of the ITAA 1997 in the year incurred if it is revenue (rather than capital) in nature. The deduction will be available if the other elements of the section are satisfied and there are no other provisions providing otherwise (e.g. the expenditure will not be deductible to the extent the asset is used for a private or domestic purpose). If the expenditure is capital, it may be deductible over time in accordance with Division 40 of the ITAA 1997, either under the core provisions in Subdivision 40-B, the low-value pool rules in Subdivision 40-E or the rules for certain primary producer assets in Subdivision 40-F.

30. The two rules set out in this Practice Statement provide a less onerous approach to evidencing compliance with the low-cost asset provisions. They will allow businesses to demonstrate practical compliance with the law in a way that is less costly while still having regard to the real weight of the compliance issue and the revenue involved.

General qualifications

31. The general qualifications set out in paragraphs 4 and 5 of this Practice Statement are designed to exclude from its scope expenditure that is either:

- likely to be capital in nature because it relates to the profit yielding structure of the business; or
- dealt by special rules or where special considerations apply (e.g. expenditure on trading stock and spare parts).

Threshold rule

32. The threshold rule set out in paragraphs 9 to 11 provides a practical approach to determining when it can be assumed that expenditure on those low cost items is revenue in nature. Assets of this nature typically have a short life, and may be subject to breakage or loss. Determining the precise character of expenditure on these minor items according to the principles laid down by the courts can be difficult, as the application of those principles depends on a range of factors. The threshold rule reflects that the expenditure covered by it is likely to be revenue in nature and that enquiring further is likely to involve substantial cost without materially changing the outcome.

Sampling rule

33. The sampling rule set out in paragraphs 12 to 27 is designed to provide an administratively cheaper means for businesses to identify expenditure that is revenue in nature. For some businesses, with a significant quantity of low cost purchases, having to separately identify and allocate expenditure introduces significant compliance costs. The sampling rule addresses these costs by allowing

the taxpayer to reliably estimate and allocate the amount of revenue and capital expenditure as against having to individually identify each item.

34. The sampling rule has been designed to dovetail with the rules for low-value pools in Division 40 of the ITAA 1997. Taxpayers wishing to use statistical sampling in other circumstances can approach the ATO to discuss their proposal.

Amendment history

Date of amendment	Part	Comment
7 December 2011	Pages 6 & 7	Updated Tax Office to ATO within diagram
15 Sept 2011	Contact details Paragraph 6 Paragraph 22	Updated. Add a reference to using the simplified depreciation rules. Updated name of Guide.
21 June 2010	Contact details	Updated.
3 Sept 2007	Paragraph 6	Include reference to small business entity (applicable from 1 July 2007).
29 Sept 2004	Paragraph 3	Include reference to subsection 73B(14) of the ITAA 1936.

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subject references: Low cost items

legislative references:
ITAA 1997 8-1
ITAA 1997 Division 27
ITAA 1997 Division 40
ITAA 1997 Subdivision 40-B
ITAA 1997 Subdivision 40-E
ITAA 1997 Subdivision 40-F

related public rulings:

related practice statements:

other related documents: ATO's Audit Statistical Sampling Guidelines

case references:

file references: 2003/3044; 2003/4024; 2003/4027; 2003/5180; 2003/10178; 2003/11436; 2003/34733

Internal Contacts

Date issued: **16 September 2003**
Date of effect: **1 July 2000**
Other Business Lines consulted **SB; LB&I; OCTC**

External Contacts

For more information phone the business info line on **13 28 66**