TR 2012/7 - Income tax: capital allowances: treatment of open pit mine site improvements

There is a Compendium for this document: **TR 2012/7EC** .

Taxation Ruling

Income tax: capital allowances: treatment of open pit mine site improvements

Contents Para

This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling considers the operation of the capital allowance rules in Division 40 of the *Income Tax Assessment Act 1997* (ITAA 1997) as they apply to an open pit mine site improvement that comes into being through the conduct of an open pit mining operation. This Ruling does not apply to other forms of mining operation such as strip mining or underground mining.

2. All references in this Ruling are to the ITAA 1997 unless otherwise indicated.

3. This Ruling specifically considers:

- the meaning of an 'improvement to land' as that phrase appears in subsection 40-30(3);
- the identifiable improvement to land in the context of an open pit mining operation;
- whether that improvement to land is a depreciating asset;
- the identifiable depreciating asset;
- whether that depreciating asset is held by the miner;
- the start time of that depreciating asset;
- when that depreciating asset is being used for a taxable purpose;

- the determination of the effective life of that depreciating asset;
- the cost of that depreciating asset;
- the operation of the balancing adjustment event provisions to that depreciating asset; and
- the treatment of that depreciating asset by the consolidation tax cost setting rules in Part 3-90.

What is an open pit?

4. Open pit mining refers to an operation whereby a mineral deposit is extracted by an excavation made at the surface of the earth that uncovers the underlying resource. A horizontal bench excavation technique is employed to remove both the waste material (known as 'overburden') and the underlying mineral deposit. As the operation progresses the resultant open pit that emerges will typically be roughly conical in shape, with the average slope of the pit walls engineered at such an angle so as to provide an efficient and safe mining environment.

5. Vehicular access within the pit is via a network of haulage roads, which are formed as a specifically shaped element of the perimeter wall and are seen to spiral or zigzag down to the areas of the mine where the extraction of overburden and mineralised rock occurs. Predominantly, the profile of the pit will be temporary in nature, with the profile being reshaped as the pit expands outwards and downwards, thereby growing ever larger with the capacity for deeper and wider excavation. These expansions are typically done in a series of planned phases known as 'pushbacks'.

6. The term 'open pit' for the purposes of this Ruling means the changed configuration of land from its natural state (as described in paragraphs 4 and 5 of this Ruling), as it exists from time-to-time, that comes into being through the conduct of an open pit mining operation.

7. Paragraphs 66 to 75 of this Ruling provide further explanation of what an open pit is and how it is created through an open pit mining operation.

Ruling

An open pit mine site improvement is an improvement to land

8. In accordance with Division 40, a deduction may be allowed over time for the decline in value of a depreciating asset. Paragraph 40-30(1)(a) provides that land, *prima facie*, cannot constitute a depreciating asset. Subsection 40-30(3) operates to limit this exception by providing that an *improvement to land*, or a fixture on land, is to be recognised as an asset separate from the land for the purpose of applying Division 40.

9. The term improvement to land is not defined however the concept of an improvement to land has been widely considered in case law. The principles that can be extracted from the relevant cases, when considered in the context of Division 40, provide that an improvement to land is an identifiable alteration to the land that enhances the usefulness of the land to the user.

10. An open pit is an improvement to land for the purposes of subsection 40-30(3) where it enhances the usefulness of the land to a user of the pit. Subsequent references in this Ruling to an 'open pit mine site improvement' or 'pit' are references to such an improvement.

11. An open pit mine site improvement encompasses all of the variously described structural elements of a typical pit, as they exist from time-to-time, such as batters, berms, benches, windrows and haulage roads. The Commissioner considers that an open pit mine site improvement is a single improvement to land as that phrase appears in subsection 40-30(3). It is the gross change to the natural surface of the earth – the pit – that is the identified improvement for the purposes of the subsection.

Elements of the pit are not separate improvements

12. It is the pit taken as a whole, and as it exists from time-to-time, that provides the recognised enhanced use of the land to the miner. The integrated nature of the structural elements of a pit supports an interpretation that there is a single improvement to land, with the structural elements forming part of the single improvement. Examined individually in the context of an open pit mining operation, the variously described structural elements cannot independently deliver an improvement to land. That is, without the pit wall the haulage roads could not exist nor could the pit wall come into being without the haulage roads providing access. It is the entire pit, viewed as a single alteration to the land, which enables a mineral deposit to be extracted and brought to the surface in a safe and efficient manner.

13. It is therefore the entire pit that is statutorily severed from the land by subsection 40-30(3). It is this single mine site improvement that is the asset to be tested against the definition of a depreciating asset.

An open pit mine site improvement is an improvement to land that is a depreciating asset

14. Subsection 40-25(1) outlines the two conditions that must be satisfied before a deduction for decline in value is allowed. Firstly, the item must be a depreciating asset, and if that requirement is satisfied, the depreciating asset must be held by the taxpayer seeking the deduction.

15. Subsection 40-30(1) provides the definition of a depreciating asset. The item must be *an asset* that has a *limited effective life* and can reasonably be *expected to decline in value over the time it is in use*. Further, the item *cannot be land*, trading stock or an intangible asset that is not mentioned in subsection 40-30(2).

16. The meaning of 'an asset' is not defined in the ITAA 1997. In the context of Division 40 an asset is taken to have the broad meaning of something that is capable of being put to use in the business of the holder. It is accepted that an open pit mine site improvement is an asset of the miner for the following reasons:

- subsection 40-30(3) requires that an open pit mine site improvement is considered to be *an asset* separate to the land; and
- an open pit mine site improvement is something recognised in the mining industry as having commercial and economic value to the miner.

17. An open pit mine site improvement has a limited effective life. A limited effective life is taken to mean there are a finite number of years that an asset can be used to produce income. It is accepted that a pit has a finite income producing life.

18. An open pit mine site improvement is expected to decline in value over the period it is used. The pushback expansion of the pit and consequent extraction of hard rock reduces the size of the mineral deposit to which the pit provides access. In this sense, the pit at some point in time will become less valuable to the miner as its useful life diminishes.

19. Subsection 40-30(3) proceeds on the basis that an improvement to land (or a fixture on the land) is an asset and deems it to be separate from the land itself. This deemed severance has the effect of causing the improvement or fixture to lose its character of being land such that the exclusion of land in paragraph 40-30(1)(a) is overridden. To interpret the provisions otherwise would nullify the intended operation of subsection 40-30(3) in respect of land improvements.

20. It follows that an open pit mine site improvement is a single improvement to land that meets the conditions to be a depreciating asset.[1]

The open pit mine site improvement is a single depreciating asset

21. The recognised improvement to land in the context of an open pit mining operation is the pit as it exists from time-to-time. It is the pit, viewed as a whole, which delivers the enhancement to the land for the miner that attracts the operation of subsection 40-30(3). On this view, it is only the pit that can satisfy the definition to be identified as a deprecating asset.

[1] So long, of course, as it is not trading stock.

22. The Commissioner considers that subsection 40-30(4) does not operate to identify any of the lesser structural elements of the pit as separate depreciating assets. Firstly, that these lesser elements of a pit (such as the roads and the pit wall) are described separately by the mining industry as features of a pit does not necessarily characterise these elements as separate improvements to land for the purposes of the capital allowance rules. Secondly, for a pit to be considered to be a composite item (as countenanced in the opening words of the subsection) it is required that the lesser elements of the pit be capable of separate existence. These elements cannot exist separately; each element relying on other elements for its own existence.

23. Alternatively, in the event that structural elements are separate improvements and that the pit is a composite item such that subsection 40-30(4) needs to be considered, the question of whether a composite item itself is a depreciating asset or whether its components are separate depreciating assets is a question of fact and degree to be objectively determined in light of all of the particular circumstances. An examination of the degree of physical integration of the elements of an asset, and the purpose or function it serves in its business context, assists in making an objective consideration as to whether a particular composite item is itself a single depreciating asset. A pit exists as a physically integrated whole that provides access to an underlying mineral deposit such that the deposit can be safely and efficiently extracted and transported to the surface. This mining function is only performed by all of the structural elements of the pit functioning together in an interdependent manner. The structural elements of a pit are not separately capable of existence or of achieving the recognised extraction function of the pit.

24. For these reasons the entire pit, rather than any of the lesser described structural features, will constitute the depreciating asset for which a deduction for decline in value can be worked out. The pit is identifiable as having its own life in effective use in enabling a mineral deposit to be extracted and can reasonably be expected to decline in value over that life.

25. It follows that the conduct of a planned pushback phase of expansion of the pit alters and typically delivers improvements to an existing depreciating asset. Each pushback phase maintains sufficient working area at the extraction interface of the pit and provides access to the remaining mineral deposit; thereby enhancing an existing depreciating asset rather than creating a new asset, or destroying an existing one.

The open pit mine site improvement must be held

26. Subsection 40-25(1) provides that a depreciating asset must be held at some time during the income year before a deduction for a decline in the asset's value can be allowed. The table in section 40-40 is used to determine the holder of a depreciating asset.

27. If the miner owns the land in which the pit emerges as a result of an open pit mining operation, item 10 of the table in section 40-40 provides that the miner holds the pit as it comes into being.

28. If the miner owns the mining right providing permission to extract the mineral deposit item 3 of the table in section 40-40 provides that the owner of the mining right holds the pit as it eventuates. Where there is a change in identity of the miner the new miner will become the holder of the pit that existed at the time the change occurred. It is not necessary that the mining right owner originally constructed the pit in order for it to be identified as the holder of the pit under item 3 of the table.

The open pit mine site improvement's start time occurs when the pit is used to further its own construction or extract ore

29. Section 40-60 provides that a depreciating asset commences to decline in value from the time its 'start time' occurs. It is by reference to this time that a deduction for decline in value can be worked out.

30. Section 40-60 defines the start time of a depreciating asset to be when you first use it, or have it installed ready for use, for any purpose. As a pit isn't installed within the normal meaning of that word, the start time for a pit will be when the pit is first used. A pit is in use from the first time it becomes necessary to use the pit to further its own construction or to extract mineralised rock. That will typically be sometime after the vegetation and top soil above the hard rock has been removed.

The open pit mine site improvement is being used for a taxable purpose from its start time

31. Subsection 40-25(2) provides that a deduction for the decline in value of a depreciating asset is reduced by that part of the decline in value that is attributable to the use of the asset for a purpose other than a taxable purpose.

32. Paragraph 40-25(7)(a) defines a taxable purpose to be the purpose of producing taxable income. Subsection 995-1(1) defines the purpose of producing taxable income to mean something done for the purpose of gaining or producing assessable income or in carrying on a business for the purpose of gaining or producing assessable income.

33. It follows that an open pit mine site improvement is being used for a taxable purpose from the time it is being used as part of the miner's activities in conducting a mining business. This time will equate to the depreciating asset's start time, as described in paragraph 30 of this Ruling.

The effective life of an open pit mine site improvement is likely to equate to the expected working life of the mine

34. Subsection 40-95(1) provides that the holder of a depreciating asset must:

- use an effective life determined by the Commissioner under section 40-100; or
- itself work out the effective life under section 40-105.

35. In making a determination, subsection 40-100(4) instructs the Commissioner to consider the period during which the depreciating asset can be used by any entity for a taxable purpose. This instruction supports a determination that the effective life of the pit will typically equate to its planned and therefore predictable useful life. In a one pit mine, that would typically be expected to correspond to the estimated life of the mine.

36. Where a mining operation has within its boundaries two or more separate and distinct pits, each pit would constitute a separate depreciating asset. Each pit in this scenario will have its own effective life which will typically equate to the planned and therefore predictable useful life of that individual pit.

37. Subsection 40-110(1) provides that the effective life of a pit is able to be recalculated because of changed circumstances relating to the nature of use of the asset. For example, the miner may choose to recalculate the effective life of the pit where the mine plan is amended at some later time that results in a change of the mine life from what was envisaged when the initial estimate was made.

Working out the cost of an open pit mine site improvement

38. The cost of a depreciating asset is worked out in Subdivision 40-C. Sections 40-215 and 40-220 provide that the cost of a depreciating asset is reduced by amounts that would otherwise be included in its cost; either because the amount is deductible or taken into account in working out a deduction under another provision or is an amount not of a capital nature.

39. Any expenditure incurred in establishing or expanding an open pit mine site improvement that is deductible under section 8-1 would not form part of the cost of the pit.

40. Taxation Ruling TR 95/36[2] discusses the Commissioner's view as to extent of expenditure in establishing or expanding a pit that would be deductible to the miner on revenue account.

[2] TR 95/36: *Income tax: characterisation of expenditure incurred in establishing and extending a mine*.

The operation of the balancing adjustment event provisions to an open pit mine site improvement

41. A balancing adjustment event happens if the holder of a depreciating asset ceases to hold the asset or stops using the asset for any purpose and expects never to use it again.[3] It follows that a balancing adjustment event will arise to the miner where a pit is directly sold to another entity.

42. Section 40-285 describes the consequences of a balancing adjustment event. If a depreciating asset's termination value exceeds its adjustable value, the difference is included in the assessable income of the entity ceasing to hold the asset. If the asset's adjustable value exceeds its termination value, the difference is allowed as a deduction to the entity ceasing to hold the asset.

43. A condition that must be satisfied before a balancing adjustment can arise is that the entity ceasing to hold the depreciating asset worked out a decline in value for the asset under Subdivision 40-B.

44. It is considered that a decline in value is worked out for a depreciating asset even where the cost of the asset has been reduced by section 40-215 or 40-220 to nil. In this situation, the adjustable value of the depreciating asset will be nil.

The pushback process does not trigger a balancing adjustment event as a consequence of the split asset provision having application

45. Where the holder of a depreciating asset stops holding part of a depreciating asset, subsection 40-115(2) applies to treat the asset as having been split into parts just before a part of the asset ceases to be held. A balancing adjustment event can then apply in respect of the part that is no longer held. The widening and deepening of a pit is not considered to trigger the operation of the split asset provision in the capital allowance rules.

46. Given that the asset is the entirety of the pit as it exists from time-to-time, there is no splitting of the pit as a result of the conduct of a planned pushback phase, nor does any part of the pit cease to be held. The conduct of a planned pushback rather alters the profile, and improves the usefulness, of an existing depreciating asset. No part of the pit stops being held or stops being used as a result of the conduct of a planned pushback phase. The enlargement of an existing depreciating asset, enhancing its usefulness for continued operation in the taxpayer's business, is in no sense the end of any part of it and does not result in any part of that asset being split from the remainder.

[3] Paragraphs 40-295(1)(a) and (b).

The open pit mine site improvement is an asset recognised under Part 3-90 when the taxpayer holding the pit joins a consolidated (or MEC) group

47. Part 3-90 allows groups of certain wholly-owned entities to choose to form a consolidated group such that the members of the group are treated as a single entity for income tax purposes. The head company of the consolidated group is the only recognised taxpayer of the group.

48. Division 701 contains the core tax cost setting rules that apply to establish the tax costs of each asset that a subsidiary member brings into the group when it joins. Subsection 701-10(3) provides that the object of the tax cost setting process is to set a cost for the assets of the joining entity that reflects the group's cost of acquiring that entity.

49. Taxation Ruling TR 2004/13[4] provides the Commissioner's view that anything recognised in commerce and business as having economic value to the joining entity would be an asset of that entity for purposes of the consolidation tax cost setting rules. Further, TR 2004/13 provides that assets recognised under the *Income Tax Assessment Act 1936* and the ITAA 1997 would come within the ordinary commercial or business meaning of an asset for Part 3-90 purposes.[5]

50. An open pit mine site improvement that is a depreciating asset would be an asset recognised in the event the holder of the pit joins a consolidated group. The extent and degree to which the assets of the joining entity should be separately identified or treated as composite items for consolidation tax cost setting purposes mirrors the approach adopted under the capital allowance rules. It would be the pit that is a recognised asset of the joining entity for consolidation purposes rather than any of the lesser described structural elements of the pit.

51. A pit held by a joining entity will be a reset cost base asset and therefore have its reset tax cost worked out by an operation of the specific tax cost setting rules in Division 705. The tax cost setting amount for an asset is worked out by allocating a portion of the joining entity's allocable cost amount to that asset by reference to the market values of all the reset cost base assets of the joining entity.

52. Section 701-55 describes how other provisions in the income tax law should be applied to an asset that has had its tax cost set by an operation of the consolidation tax cost setting rules.

53. Where the asset is a depreciating asset, paragraph 701-55(2)(a) provides that the capital allowance rules apply as if the head company had acquired the asset at the joining time for a payment equal to its tax cost setting amount.

---

[4] *Income tax: the meaning of an asset for the purposes of Part 3-90 of the Income Tax Assessment Act 1997*.
[5] Paragraph 11.

54. It follows that a pit held by a miner when it joins a consolidated group will be treated as if it were directly acquired by the head company at that time for a payment equal to its tax cost setting amount. This amount becomes the first element of the cost of the pit for which a deduction for decline in value can subsequently be worked out by the head company.

Modified application of Part 3-90 where the miner is a continuing majority-owned entity

55. Section 701A-10 of the *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A) may apply to modify the operation of the consolidation tax cost setting rules to a pit. The section applies if:

- the miner is a continuing majority-owned entity[6] when it becomes a member of a consolidated group;
- the terminating value of the pit is less than the tax cost setting amount set for the pit;
- the pit existed at the start of 27 June 2002;
- more than 50% of the expenditure incurred in constructing the pit was of a revenue nature and allowable as a deduction to the miner; and
- if a balancing adjustment event happened in relation to the pit before the miner became a member of a consolidated group, there was roll-over relief obtained under section 40-340.

56. The most immediate modification for the head company of the consolidated group that the miner joins, where section 701A-10 of the IT(TP)A applies, is that the tax cost setting amount for the pit will be reduced to the terminating value of the pit just before the joining time. Subsection 705-30(3) provides that the terminating value for a depreciating asset is equal to the asset's adjustable value just before the joining time.

Example

57. *Hard Rock Co commenced an open pit mining operation whereby a pit called the Samaerro Pit came into existence on 1 July 2010. The initial mine plan indicates that the open pit mining operation will continue in operation until 2030.*

[6] As defined in subsection 701A-1 of the IT(TP)A.

2010-11 income year

58. *Hard Rock Co incurs $20 million of 'in-pit' expenditure. The Samaerro Pit that eventuates is a depreciating asset. $19 million (or 95%) of the expenditure is immediately deductible to Hard Rock Co per TR 95/36 as a revenue expense. The remaining expenditure ($1 million) is of a capital nature and constitutes the cost of the pit for Division 40 purposes.*

59. *Hard Rock Co chooses the prime cost method and self-assesses an effective life for the Samaerro Pit of 20 years.*

> *The deduction for the decline in value of the Samaerro Pit is $50,000.*[7]
>
> *The adjustable value of the Samaerro Pit at year-end is $950,000.*[8]

2011-12 income year

60. *Hard Rock Co incurs an additional $28.5 million of in-pit expenditure in respect of the Samaerro Pit operation. 95% of this expenditure is immediately deductible on revenue account. The capital expenditure component ($1.425 million) forms part of the second element of cost of the Samaerro Pit.*

> *The deduction for the decline in value of the Samaerro Pit is $125,000.*[9]
>
> *The adjustable value of the Samaerro Pit at year-end is $2.25 million.*[10]

2012-13 income year

61. *Hard Rock Co is acquired by the Allway consolidated group on 1 July 2012. The Allway group pays $500 million for Hard Rock Co. The consolidation cost setting rules apply such that a tax cost of $50 million is set for the Samaerro Pit. This reset cost establishes a new cost for the pit for Division 40 purposes.*

62. *Allway incurs an additional $26 million of in-pit expenditure on the Samaerro Pit operation. 95% of this expenditure is immediately deductible on revenue account. The remaining capital expenditure ($1.3 million) forms part of the second element of cost of the Samaerro Pit.*

---

[7] $1m x [100%/20]. Refer subsection 40-75(1).
[8] Paragraph 40-85(1)(b).
[9] [950,000 + 1,425,000] x [100%/19]. Refer paragraph 40-75(2)(b) and subsection 40-75(3).
[10] [950,000 + 1,425,000] - 125,000. Refer paragraph 40-85(1)(c).

Date of effect

63. This Ruling applies to years of income commencing both before and after its date of issue. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

64. The ATO has previously issued four ATO Interpretative Decisions, ATO ID 2007/11, ATO ID 2007/12, ATO ID 2007/13 and ATO ID 2007/14, which set out ATO views on various aspects of the treatment of open pits under Division 40. Representatives of the mining industry requested that those ATO IDs be reviewed by the ATO. In consequence of that review, the ATO IDs were withdrawn on 9 May 2012 and the draft version of this Ruling was released for public comment.

65. We anticipate that the views in this Ruling will provide a more favourable outcome to taxpayers than would an application of the views in the ATO IDs. However, a taxpayer should approach the ATO to discuss appropriate action if:

- they have applied the views in those ATO IDs in their entirety to an arrangement; and
- the application of those views in their entirety to that arrangement results in a more favourable outcome than applying the views in this Ruling; and
- they do not wish to apply the views in this Ruling to that arrangement.

Commissioner of Taxation
21 November 2012

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.

An open pit mine site improvement

66. The phrase 'open pit mine site improvement' describes an open pit (see paragraphs 4 to 6 of this Ruling) that enhances the usefulness of the land to a user of the pit and so is an improvement to land for the purposes of subsection 40-30(3). References in this Explanation to a 'pit' are a shorthand reference to the open pit mine site improvement.

67. Planning a pit is done from the bottom-up after first ascertaining the economic limit of the base mineral deposit. A safe pit slope and road access must be maintained as the pit is expanded by making it first wider at the surface and then excavating the side walls outward such that the base can be deepened. Typically, a pit is mined by conventional drill and blast methods that require waste and valuable rock to be loaded onto heavy load vehicles that transport the material out of the pit.

68. The waste material removed is typically described as 'overburden', which represents the layers of soil and rock and sub-grade mineralised material that covers a mineral deposit. Overburden is removed prior to and during the mining of the economically valuable deposit.

69. The advantage of an open pit mining operation is that a large percentage of a mineral deposit is able to be extracted in a safe and efficient manner. The decision whether to adopt an open pit operation is dependent on the economic viability of the project, which will include an analysis of the amount of overburden to be removed and the revenues likely to be derived when the deposit is sold on the open market.

70. A pit is excavated as a series of horizontal benches at increased depths. The primary elements of a pit are haulage roads, extraction benches and cutback benches.

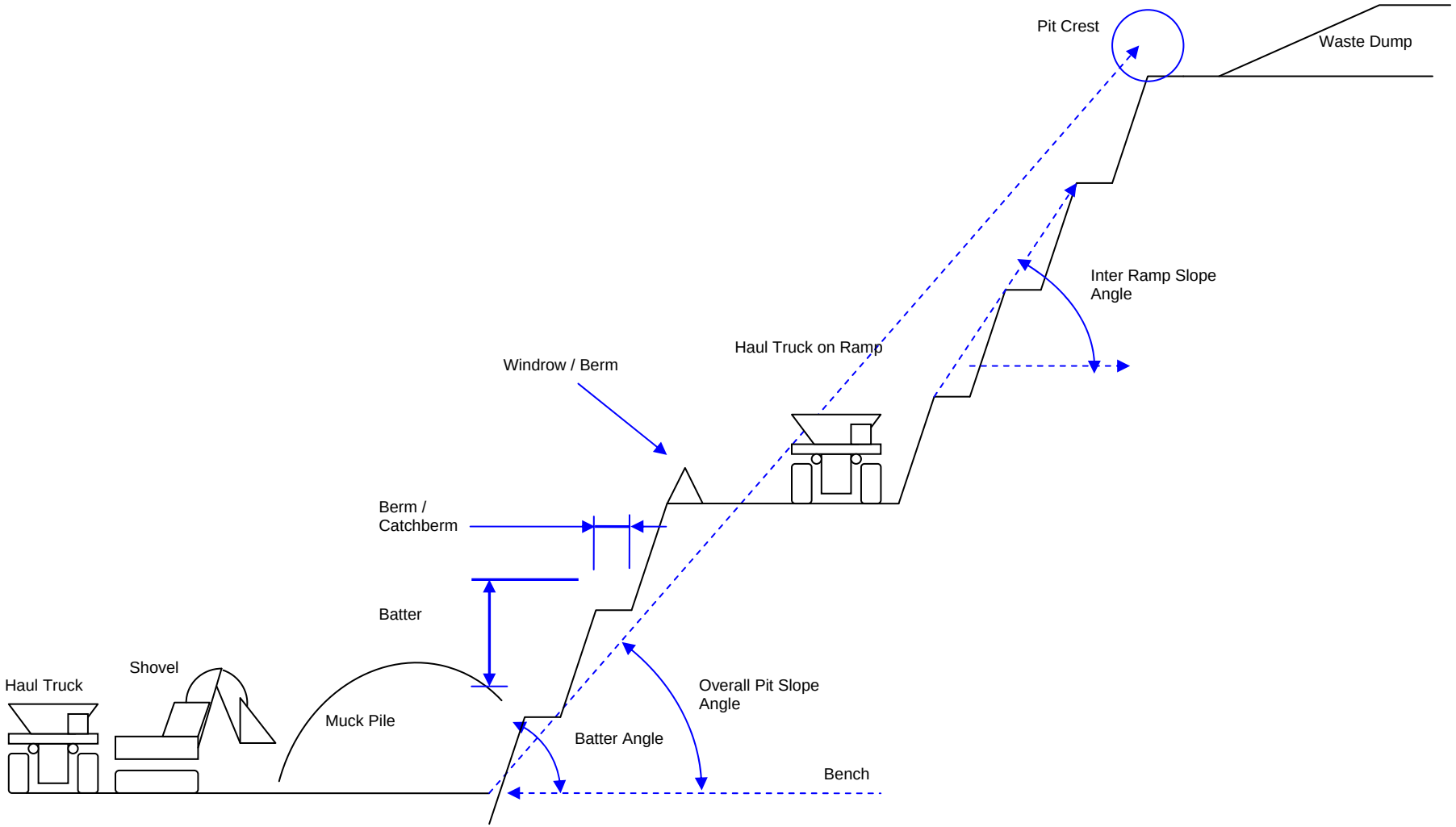
71. Haulage roads that are a shaped element of the pit wall provide vehicular access from the surface to areas of current extraction within the pit. Segments of a haulage road are commonly described as ramps and switchbacks. Ramps describe the connected inclined roads traversed by vehicles. Switchbacks describe the part of the ramp where the direction of the road doubles back on itself. Haulage roads typically consist of a base layer of blasted waste rock upon which another layer of specifically selected waste rock is laid and compacted. A surface layer of gravel may then be applied to complete the formation.

72. Extraction benches represent the levelled areas where extraction of overburden and mineralised material takes place. Cutback benches describe the current setting where excavation concerned with the removal of waste overburden and sub-mineralised material is being undertaken for the purpose of increasing the size of the pit to expose further mineralised areas and to maintain adequate working space on the extraction bench. Benches feature windrows, batters, and berms or catchberms.

73. Windrows (also sometimes called berms) are piled mounded earthen material that function as a safety barrier at the edge of an elevated bench or haul road to prevent rock falls onto a lower bench or haul road. Batters are the sloped walls of the open pit. Generally, batters are shaped earth but can be further supported, where geotechnical properties of the rock require, by mesh or strapping. Berms or catchberms are flat areas of earth between batters that act as safety barriers by catching rock falls from above and, in concert with the angle of the shaped batters, contribute to maintaining the average safe pit wall slope.

74. Batters, berms, haulage roads, windrows and mining benches are all essential elements of a pit. As well as improving the efficiency of mineral extraction, they are essential for a safe working environment at the mine face.

75. The following diagram illustrates the physical form of the variously described elements of an open pit mine site improvement:



The meaning of an improvement to land

76. Under Division 40, a deduction may be allowable over time for the cost of a depreciating asset. A key element of the operation of Division 40 is the identification of a 'depreciating asset'.

77. The term depreciating asset is defined in section 40-30. Subsection 40-30(1) provides as follows:

> A ***depreciating asset*** is an asset that has a limited *effective life and can reasonably be expected to decline in value over the time it is used, except:
>
> (a) land; or
>
> (b) an item of *trading stock; or
>
> (c) an intangible asset, unless it is mentioned in subsection (2).

78. Relevantly for the subject matter of this Ruling, subsection 40-30(3) provides as follows:

> This Division applies to an improvement to land, or a fixture on land, whether the improvement or fixture is removable or not, as if it were an asset separate from the land.

79. It is noted that a depreciating asset, *prima facie*, does not include land (paragraph 40-30(1)(a)). The term 'land' is not defined for the purposes of section 40-30. The policy rationale for excluding land was that land does not usually have a limited effective life.[11]

80. In its primary ordinary meaning, land is the solid part of the earth's surface.[12] The common law has recognised, however, that land includes more than the physical structure of the earth. Through the maxim *quicquid plantatur solo, solo cedit*, it recognised that 'whatever is affixed to the soil becomes part of the soil'. From this developed the notion that things affixed to the land (like trees, crops, buildings, walls, fences, etcetera) are a part of the land. These are called 'fixtures'.

81. In the context of Division 40, the Commissioner considers that the term 'land' as used in paragraph 40-30(1)(a) means land in this generally understood physical sense, that is, the soil. The context provided by subsection 40-30(3) indicates that 'land' as used in paragraph 40-30(1)(a) was intended to draw in concepts developed by the common law and equity in relation to land, hence the need to treat fixtures as being separate to the land.

82. Subsection 40-30(3) therefore treats improvements to land and fixtures on land as being separate to land to prevent the paragraph 40-30(1)(a) exclusion of land from being a depreciating asset applying to things that are treated by law to be part of the land.

---

[11] See paragraph 1.16 of the revised Explanatory Memorandum to the New Business Tax System (Capital Allowances) Bill 2001.
[12] See definition of 'land' in the *Concise Oxford Australian Dictionary*, *4th Edition*.

83. The meaning of 'improvement' is not defined for the purposes of Division 40 and accordingly takes its ordinary meaning in the context in which it appears.

84. Various branches of the law have developed a concept of 'improvements' to land. In relation to land taxation, the concept of improvements is used in the context of statutes which impose tax on the 'unimproved value' of land. Improvements are those alterations which are disregarded in determining the value of land subject to tax.

85. In considering what constituted 'improvements' to land under the then existing Commonwealth land tax legislation Griffith CJ in *Morrison v. Federal Commissioner of Land Tax* (1914) 17 CLR 498 (*Morrison*) said an improvement was:

> Any operation of man on land which has the effect of enhancing its value…[13]

86. This interpretation was subsequently followed in numerous land tax cases[14] and adopted by the High Court in *Brisbane City Council v. Valuer-General (Queensland)* [1978] HCA 40; (1978) 140 CLR 41 (*Brisbane City Council*) where the Court was asked to determine the value of land upon part of which a dam had been constructed. It considered that improvements:

> …consist of something done which has enhanced the value of land. To build a dam, or to improve a watercourse, so that water may be collected on or flow over land may improve the land, but it is the dam or the watercourse, and not the water, that constitutes the improvement.[15]

87. That an improvement enhances the value of land on or to which it is made has been accepted and applied in other statutory contexts. In those cases, it appears an 'improvement' has been given a somewhat broader meaning to include an alteration that improves the use of the land to the user. In *Commonwealth of Australia v. Oldfield* (1976) 133 CLR 612; 10 ALR 243, a lease allowed the lessor to take back land, subject to the requirement that it pay the lessee for improvements 'on or effected to' the land. Applying *Morrison*, Jacobs J held that 'improvements' should be given a meaning which 'would include what is done in improvement of quality of the soil and thereby the usefulness of the land'.[16]

---

[13] at 503
[14] See *Campbell v. Deputy Federal Commissioner of Land Tax (NSW)* (1915) 20 CLR 49; *Fisher v. Deputy Federal Commissioner of Land Tax (NSW)* (1915) 20 CLR 242; *Keogh v. Deputy Federal Commissioner of Land Tax (NSW)* (1915) 20 CLR 258; *McGeoch v. Federal Commissioner of Land Tax* (1929) 43 CLR 277.
[15] at 51.
[16] 133 CLR 612 at 618.

88. In *Dampier Mining Co Ltd v. Federal Commissioner of Taxation* 79 ATC 4469; (1979) 10 ATR 193, the Federal Court interpreted the meaning of improvement in relation to income tax. That case concerned the deductibility of expenditure on improvements made to the sea-bed. Brennan J, when discussing *Brisbane City Council*, said:

> Though the facts of that case were significantly different from the facts of the present case, one cannot find an 'improvement' in the present case unless the dredging enhances the value of land, *or makes the use of land more efficient*. In my opinion, it does not. The dredging was not an improvement to the sea-bed and navigational aids, for the improving quality of the dredging consists in the removal of an obstruction to navigation, and the consequent deepening of the water available for ships. The improvement to navigation is found in the increased depth of the water, though that is a reciprocal effect of decreasing the height of the sea-bed. The land, notionally separated from the water, is made *no more efficient for man's use*, and no more valuable, by dredging.[17] [*emphasis added*]

Approach to be adopted in interpreting 'improvement to land' in subsection 40-30(3)

89. It is evident that subsection 40-30(3) treats improvements and fixtures as being separate to land because the Parliament did not want the paragraph 40-30(1)(a) exclusion of land from being a depreciating asset to apply to certain things that are legally treated as part of the land.

90. It is apparent, therefore, that the meaning of the term 'improvement' in subsection 40-30(3) needs to be found principally in the concepts developed in land tax law and then expanded somewhat in the context of Division 40 to also capture those alterations that increase the usefulness of the land to the user.

91. The Commissioner's view is that an improvement, as that word appears in Division 40, would constitute any alteration to land that is considered an enhancement to the user even if the alteration has not, in fact, increased the value of the land.

92. For the purposes of subsection 40-30(3), an improvement to land does not include a fixture on the land. Fixtures on land would usually be considered as an improvement to land under the approach set out above. However, because subsection 40-30(3) explicitly refers to fixtures, the term 'improvement to land' in that subsection does not include them.

[17] 79 ATC 4469 at 4475.

The whole pit is an improvement to land

93. The legislative scheme of section 40-30 requires an identification of the improvement to land that is to be treated as separate to the land. It is this identified improvement that can then be tested against the conditions to be a depreciating asset. An improvement to land is therefore the identified alteration that delivers an advantage to the user.

94. In the context of an open pit mining operation it can only be the pit, taken as a whole, that delivers the advantage. It is the pit, functioning as an integrated earthwork, which provides access to the mineral deposit and enables that deposit to be extracted and transported out of the pit. The structural elements of a pit are viewed as contributing to the efficient functioning of an open pit mining operation, rather than delivering their own independent enhancement to the land. In contrast, a dam and levy bank, constructed independently from each other on a property, would clearly be identifiable as separate improvements to land in that each alteration delivers its own recognisable enhancement to the use of the land.

When is an improvement to land a depreciating asset?

95. Having established that an alteration is an improvement to land it is then necessary to determine if that improvement is a depreciating asset. As the note to subsection 40-30(3) points out, an improvement to land will only be a depreciating asset if it falls within the definition in subsection 40-30(1).

96. Subsection 40-30(1) defines a depreciating asset to be:

> A ***depreciating asset*** is an asset that has a limited effective life and can reasonably be expected to decline in value over the time it is used, except:
>
> (a) land; or
>
> (b) an item of trading stock; or
>
> (c) an intangible asset, unless it is mentioned in subsection (2).

97. Therefore, each of the following matters need to be considered in establishing whether a depreciating asset exists:

- there is an asset;
- that has a limited effective life;
- that can be expected to decline in value over the time it is used; and
- is not land, an item of trading stock or an intangible asset that is not mentioned in subsection 40-30(2).

Each of these matters will be examined in the context of conducting an open pit mining operation.

A pit is an asset

98. The concept of 'asset' is not defined for income tax purposes. It is therefore useful to consider the ordinary meaning of asset in the context of the capital allowance rules. The *Macquarie Dictionary (3rd revised edition)* defines an asset to be a 'useful thing or quality' or 'an item of property; an economic resource'.

99. In the context of Division 40, which provides a deduction for the cost of a depreciating asset over the time of its useful life, an asset is considered something that is capable of being put to use in the taxpayer's business.

100. Further, in the context of improvements to land, subsection 40-30(3) operates to sever the improvement from the land and treats the improvement '…as if it were an asset separate from the land'. This statutory severance therefore deems the improvement to be a separately identifiable asset in its own right.

101. It follows that a pit is an asset of the miner for the following reasons:

- a pit is something used by the miner to conduct their business and is therefore recognised as having commercial and economic value to the miner; and
- subsection 40-30(3) requires that a pit is treated by the capital allowance provisions as if it were *an asset* separate from the land.

102. Because a pit is an improvement to land, the fact that it cannot be physically separated and sold does not prevent the pit from being identified as an asset for the purposes of the capital allowance rules.

A pit has a limited effective life

103. The phrase 'limited effective life' as it appears in subsection 40-30(1) is interpreted as meaning that the asset can be used for a limited time.

104. The period for which an open pit mine site improvement will exist and function to provide access to a mineral deposit is planned and predictable notwithstanding taxpayers' mine plans are subject to constant review and variation because of various technical and market factors. The fact that mining will only continue for the period the operation remains economically viable or until the mineral deposit is exhausted provides the necessary evidence that the pit will have a limited useful life.

A pit will decline in value over the time it is used

105. This condition requires that the identified improvement to land is capable of use. An improvement to land can only be used if it is tangible and physically identifiable as separate from the land in its natural state and also capable of use as a discrete thing. Only improvements to land with that character could be used in and of themselves.

106. The law has recognised as improvements to land a range of things done to improve the land. For example, the removal of noxious weeds, the felling of trees and removal of rocks could all be described in some contexts as improvements to land because they improve the profit yielding capability of the land. However, improvements of that kind do not exist in a state that is capable of use separately from the land itself. For example, the felling of trees on agricultural land may make the land capable of use in farming. However, that benefit is intangible and incapable of use in its own right.

107. On the other hand, improvements to the shape of the land other than mere earthworks, such as through the construction of roads, dams, levees, and drains, all create tangible physically identifiable artefacts. Such items can be recognised as having a character separate from the land of which they are part and are capable of being put to use in that sense separately to the land of which they are part in a taxpayer's business. Such items are therefore capable of recognition as assets that could also be depreciating assets if they have a limited effective life and could reasonably be expected to decline in value over the time they are used. It has been suggested that the pit is not something that is used (or indeed designed to be used) because it is merely the consequence or result of excavation and construction works. However, even though its creation might be characterised this way, the pit is nonetheless a reconfiguration of the land such that a portion of the surface of the earth is closer to an ore body than would otherwise be the case, and this depression is used constantly by a miner in gaining access to and retrieving the ore.

108. As a consequence and despite its constantly altering profile, a pit is capable of being viewed as a tangible and identifiable asset that is used in performing its discrete identifiable function of providing safe and efficient access that enables a mineral deposit to be extracted.

109. The requirement that an asset decline in value over the time that it is used does not mean that this must occur uniformly over that time. This is confirmed by the following extract from the revised Explanatory Memorandum (EM) to the New Business Tax System (Capital Allowances) Bill 2001, discussing this requirement in the depreciating asset definition:

> This does not limit depreciating assets to things that lose value steadily over their effective lives. Nor are depreciating assets limited to things that only ever decline in value. Depreciating assets may hold their value for a time, or even increase it for a time. The test of a depreciating asset requires only that the asset lose its value overall (or down to no more than scrap value) by the end of its effective life.[18]

[18] Paragraph 1.14.

110. It is accepted that a pit will decline in value over the period it is in use. Typically, there will be times when the value of a remaining deposit will increase, for example during a period when the demand (and therefore price) for the minerals being extracted increases. However, as the deposit continues to be depleted over the life of the mine it is clear enough that the pit will consequently also decline in value over that time.

A pit is not land, trading stock or an intangible asset

111. The exclusion of land from being a depreciating asset under paragraph 40-30(1)(a) has no application to improvements to land under subsection 40-30(3). That is because subsection 40-30(3) deems such improvements to be separate from the land for the purposes of Division 40. Something separated from land in this way causes the improvement to lose its character as being land for the purposes of considering whether it can be a depreciating asset.

112. This interpretation is in accordance with the following extract from the revised EM to the New Business Tax System (Capital Allowances) Bill 2001:

> Land is excluded from the definition of depreciating asset as it is not generally considered to have a limited effective life ***[Schedule 1, item 1, paragraph 40-30(1)(a)]***. However improvements to land or fixtures on land may still qualify as depreciating assets. For the purposes of Division 40, these improvements or fixtures are treated as separate assets, not as part of the land, regardless of whether they can be removed from the land or are permanently attached.[19]

113. It follows that a pit that is recognised as an improvement to land is not prevented by paragraph 40-30(1)(a) from being a depreciating asset because it is land.

114. A pit is unlikely to constitute trading stock of the miner. Trading stock is defined in section 70-10 to include anything produced, manufactured or acquired for the purpose of subsequent manufacture, sale or exchange in the ordinary course of a business. A pit eventuates in the course of the conduct of an open pit mining operation and as such typically will not constitute trading stock of the miner.

115. A pit does not constitute an intangible asset within the ordinary meaning of that word as the pit is a tangible artefact and is capable of physical use.

[19] Paragraph 1.16.

116. It follows that the Commissioner considers that a pit is identifiable as a single improvement to land that is able to satisfy the definition to be a depreciating asset from the time it commences to come into being. It is recognised that elements of the pit wall (such as the haulage roads) as they present from time to time would often usefully exist for periods substantially less than the pit as a whole, but such an observation, in all the circumstances, is not sufficient to overturn the conclusion that it is the pit as a whole which is the depreciating asset.

Identification of the pit as a single depreciating asset

117. Deductions for decline in value are worked out for an identified depreciating asset. As outlined previously, it is considered the identifiable improvement to land in the context of an open pit mining operation is the entire pit. It is this deemed asset that is tested as to whether it falls within the definition of a depreciating asset.

118. The Commissioner considers that subsection 40-30(4) does not operate to identify components of a pit as separate depreciating assets for the following reasons:

- subsection 40-30(4) can only operate in respect of components that themselves are able to satisfy the depreciating asset definition. In the Commissioner's opinion, the elements of a pit are not deemed to be assets separate from the land so cannot be separate depreciating assets,
- subsection 40-30(4) cannot apply, as for that subsection to operate the component parts of an item need to be capable of separate existence, and
- in the event subsection 40-30(4) could apply, an objective consideration of the functionality of a pit in the context of the capital allowance rules provides that the entire pit is a composite item that is a single depreciating asset.

Components of the pit are not identifiable improvements to land

119. As previously discussed, it is considered that the pit is the identifiable and tangible improvement to land. It is only the pit, functioning as an integrated earthwork, which delivers the enhanced use of the land. On this view, it is only the pit that is statutorily separated from the land such that it can be treated as an asset apart from the land.

120. No lesser element of the pit is deemed to be a separate asset by the operation of subsection 40-30(3). On this view, no lesser element of the pit is separately identifiable under the capital allowance rules. There is therefore no role for subsection 40-30(4) to perform in preferring the one or the many, as there is only one deemed asset that can fall within the depreciating asset definition.

121. Some support for this interpretation can be found in the recent Full Federal Court decision in *Mitsui & Co (Australia) Ltd v. FCT* [2012] FCAFC 109 (*Mitsui*). The question in *Mitsui* was whether an amount paid in respect of a depreciating asset was immediately deductible under section 40-80 because the asset was first used for exploration. In *Mitsui*, the depreciating asset was identified to be an interest in a production licence referable to a petroleum field. A petroleum production licence is a 'mining, quarrying or prospecting right' that is an intangible asset specifically deemed to be a depreciating asset by subsection 40-30(2). That subsection identifies particular intangible assets that are not prevented from being a depreciating asset by the general intangible asset exclusion in paragraph 40-30(1)(c).

122. The Full Federal Court in *Mitsui* held that subsection 40-30(4) was not enlivened because, even if there were separate underlying rights conferred upon the holder of a production licence, they could not be separate depreciating assets because they fell outside the deeming provision. On this aspect of the decision Emmett, Bennett and Gilmour JJ said:

> We do not consider that there is room for the application of s 40-30(4) in the present case. This is because underlying rights conferred upon the holder of a production licence are not capable of constituting separate depreciating assets. *Each asset identified by s 40-30(2) is deemed to be a depreciating asset and cannot be further divided*. A production licence is not a composite asset, because it is the licence as such, or an interest in such a licence, that falls within the definition of a mining, quarrying or prospecting right. It is thus **deemed** to be the depreciating asset by s 40-30(2). *The language of s 40-30(2) suggests that s 40-30(4) could never apply to the limited types of intangible assets that are taken to be depreciating assets by the operation of s 40-30(2)*.[20] [*Italicised emphasis added*]

123. Similarly, in the Commissioner's opinion the asset identified by subsection 40-30(3) – the pit – is deemed to be an asset and cannot be further divided into lesser depreciating assets, even if those subdivisions revealed separately existing components.

Components of the pit are not capable of separate existence

124. The Commissioner recognises, given open pit mine site improvements are not homogenous assets, that ultimately facts and circumstances will be determinative. Thus, contrary to the view expressed in this Ruling, it might be argued that various elements of the pit could constitute separate improvements to land that are deemed assets separate to the land.

[20] Paragraph 58.

125. In this regard, *Mitsui* also considered a different point to the one described above. The question was whether an item (the petroleum production licence) was a 'composite item', in the sense that it was made up of 'components'. If it wasn't, subsection 40-30(4) was not enlivened. On this point Emmett, Bennett and Gilmour JJ said:

> In any event, *for an asset to be a composite item, each of its components must nonetheless be capable of separate existence*. In the case of tangible property, that test might readily be satisfied. However, in the case of intangible property created by statute, the issue of whether an item is a composite item requires consideration of the legal character of the item in question, by reference to that statute. Thus, a production licence is a form of property created by the Petroleum Act. Its attributes must be understood in the context of the Petroleum Act. The statutory scheme of the Petroleum Act does not support the conclusion that a production licence is a composite item. Still less does it allow a conclusion that the components of a petroleum licence are separate depreciating assets. The authorisations granted by a production licence are conjunctive rights granted with respect to all graticular blocks within the production licence area. *Those authorisations are not capable of separate existence*. Section 52 does not provide for the grant of a licence conferring only some of the authorisations set out in s 52. *The authorisations granted under s 52 are not independent of each other*.[21] [*Emphasis added*]

126. In a similar way, the components of a pit are incapable of separate existence. Each component relies on another for its very existence. Any stretch of the pit wall, and its configuration, could not exist without the pit wall in its entirety. The pit wall could not be constructed without the haulage roads providing vehicular access such that overburden can be removed. The haulage roads, constructed at a necessary gradient, could not be constructed without the stability provided by the pit wall infrastructure. Similarly, the various elements of the pit wall infrastructure exist interdependently in providing a setting for the mining function to be carried out. It is simply not possible to identify a component of a pit separately from the other components. The structural elements of a pit are not capable of existing on their own as they present below the natural surface of the earth.

127. On this view the pit is not recognised as a composite item as that phrase appears in subsection 40-30(4). It is rather identified as a single integrated earthwork made up of various structural elements. It is that single item that is the identifiable depreciating asset.

[21] Paragraph 59.

If a pit is a composite item, it is this composite item that is the depreciating asset

128. While the Commissioner considers, for the reasons described above, that subsection 40-30(4) has no application in respect of a pit, it is considered that a single depreciating asset should be identified were that subsection to have application.

129. A composite item is one made up of various parts or elements that are capable of separate existence. Once a depreciating asset that is a composite item has been identified it is necessary to consider subsection 40-30(4). Subsection 40-30(4) provides that:

> **(4) The question of composite items**
>
> Whether a particular composite item is itself a ***depreciating asset*** or whether its components are separate ***depreciating assets*** is a question of fact and degree which can only be determined in light of all the circumstances of the particular case.
>
> **Example 1:**
>
> A car is made up of many separate components, but usually the car is the depreciating asset rather than each component.
>
> **Example 2:**
>
> A floating restaurant consists of many separate components (like the ship itself, stoves, fridges, furniture, crockery and cutlery), but usually these components are treated as separate depreciating assets.

130. The statute thereby directs that an objective consideration is made of something that is a composite item to identify either that (single) thing as a depreciating asset, or its components (or some combination of those components) as separate depreciating assets. The test is directed at appropriately identifying the depreciating asset for the purposes of Division 40, which is to allow a deduction over the effective life of the identified asset which reflects the diminution of economic value of that asset over its period of use.

131. The examples provided in subsection 40-30(4) assist in framing how that objective consideration ought to be applied. The first example illustrates a composite item constituting a single depreciating asset, the second illustrating a composite item that is not identified as a single depreciating asset. Examples have a role in aiding the interpretation of the provision in which they are located (see section 2-35). Section 2-45 confirms that examples form part of the ITAA 1997.[22]

[22] Section 15AD of the *Acts Interpretation Act 1901* (AIA) has recently been amended (Act No 46 of 2011) to strengthen the status of examples by providing that an example is capable of extending the operation of the provision where there is conflict between the provision and the example (paragraph 15AD(b) of the AIA).

132. The examples provide some indication of the factors to consider in identifying the appropriate asset. The first example notes that a car that is made up of many different components will usually be treated as a single composite depreciating asset. The indication here is that the component parts of the car all contribute towards the ultimate purpose to which a car is put; the safe and comfortable transportation of its passengers and cargo. Therefore, the assistance that can be taken from the first example is that components are unlikely to be recognised as separate depreciating assets where those components operate with a significant level of physical integration and interdependence in providing the function of the composite item. The first example also suggests that a composite item is more likely to constitute a single depreciating asset if the function of the item would be compromised by the removal of one of its component parts.

133. The second example provides that component parts of a floating restaurant would be identified as separate depreciating assets. Importantly, the example notes the ship itself would be considered to be a single depreciating asset, with elements of the restaurant constituting separate depreciating assets. The function of travel seems to predicate that the ship, like a car, is identified as a single depreciating asset notwithstanding that the ship itself is made up of many component parts. That the other items constitute separate depreciating assets indicates that physical separability is another factor to take into consideration. Here, the removal of a fridge or crockery would not affect the ability of the ship to perform its function. The functions that the components of the restaurant provide are independent and differentiable from each other and from the function of the ship.

134. The revised EM to the New Business Tax System (Capital Allowances) Bill 2001 supports the notion that a function test can be adopted in objectively applying subsection 40-30(4):

> Taxpayers will be required to exercise judgement in identifying the depreciating asset where the asset itself is made up of different parts and components. In doing this, the functionality test [*sic*] that is used as a basis of identifying a unit of plant in the existing plant depreciation rules can be used.[23]

135. The Commissioner outlines what is considered to be an appropriate function test in Taxation Ruling TR 94/11.[24] That Ruling outlines a function test in the context of identifying a separate unit of property for the purpose of the (then operable) general investment allowance. The Ruling outlines, on the basis of the authorities summarised therein, that a function test is a factual examination of the function that an item serves in the particular taxpayer's income producing activity.

---

[23] Paragraph 1.15.
[24] TR 94/11 *Income tax: general investment allowance - what is a unit of property?*

136. TR 94/11 provides that an item is generally identified as a single item if it has one or more of the following characteristics:

- the asset performs a separately identifiable function, where 'function' in this context refers to the kind of action or activity it allows or facilitates, or what it performs, acts, serves or operates as,
- the asset being functionally complete in itself, and
- the asset varies the performance of another asset that has its own independent function.[25]

137. An objective application of the function test provides that a pit is identifiable as a single depreciating asset. The Commissioner views the relevant function of a pit as providing access to an underlying mineral deposit such that the deposit can be safely and efficiently extracted and brought to the surface.

138. The Commissioner considers that neither any of the individual elements of a pit, nor any lesser combination of those elements than the entire pit, can constitute separate depreciating assets. What these elements contribute to the function of the pit are insufficiently complete, definable and identifiable in themselves so as to identify those elements as depreciating assets in the context of conducting an open pit mining operation. The mining function can only be performed by structural elements of the pit working together in an integrated manner.

139. This application of the function test to a pit is akin to other precedential decisions made by the Commissioner. In one decision,[26] it was found that a rail transport trackwork was itself a single depreciating asset, rather than each of the individual trackwork components constituting separate depreciating assets. In another decision[27] each 'segment' of a telecommunications system, rather than the components of each segment, was considered to be the depreciating asset.

140. In both decisions, it was found that the relevant function could only be derived from the integration of the components in a particular way. This is analogous with the contributions made by the structural elements of a pit to the mining function.

141. The fact that the components of a rail trackwork or the components of a segment of a telecommunications system perform their own roles within their respective networks and can be physically separated did not result in those components being considered separate depreciating assets. That the structural elements of a pit cannot be physically separated from the pit itself presents a stronger argument that the pit is the depreciating asset rather than any of its structural elements constituting separate depreciating assets.

[25] As set out at paragraph 3 of TR 94/11.
[26] ATO Interpretative Decision ATOID 2003/489.
[27] ATO Interpretative Decision ATOID 2011/2.

Other items located within a pit can constitute separate depreciating assets

142. That the pit is recognised as a single depreciating asset does not prevent other assets, located within the perimeter of the pit, from being recognised as separate depreciating assets.

143. For example, some pits might be of sufficient depth to require buildings for temporary storage or employee amenities to be constructed near the area where extraction activities are taking place. Such facilities would clearly be identified as separate depreciating assets, not least because they would be fixtures.

Expansion of the pit alters an existing depreciating asset

144. As described, a pit typically has a roughly conical profile that undergoes constant expansion via the pushback excavation method. The pit is typically first expanded at its circumference on the surface and then excavated downward using a benching technique to the base of the pit, while maintaining a safe average angle of the slope of the pit wall. The process of excavation involves the periodic but continuous and simultaneous construction and destruction of the various elements of the pit. Each element is temporary in nature in the sense that those existing as a result of an earlier pushback phase are obliterated, with corresponding new elements being constructed at the outer edge of the current area of excavation as the wall of the pit is pushed back.

145. The Commissioner considers that each pushback results from the use of the pit in the mining process, and typically improves the single depreciating asset, in the sense that each expansion of the pit allows access to the remaining mineral deposit and maintains sufficient working area at the base of the pit.[28] Viewed in this way, the expansion of a pit is analogous in a mining operation to an expansion of an existing processing plant facilitated by the destruction of some features of the existing structure when improvements are made to the plant.

146. On this view, the pit continues to be held by the miner, even if particular structural elements constituting a presumed static profile are destroyed as the pit expands. Viewed this way, the pit is seen to evolve organically in performing the mining function throughout its working life.

[28] Note that paragraph 1.42 of the revised EM to the New Business Tax System (Capital Allowances) Bill 2001 recognises that improvements to land that are depreciating assets can themselves be improved.

The pit must be held

147. Subsection 40-25(1) provides that a miner will only be allowed a deduction for the decline in value of a pit if it is held at any time during the income year for which the deduction is being worked out.

148. The table in section 40-40 identifies the holder of particular kinds of depreciating assets. Item 3 of the table identifies the holder of a depreciating asset that is an improvement to land subject to a quasi-ownership right.

149. A quasi-ownership right over land is defined in subsection 995-1(1) as meaning:

- a lease of the land; or
- an easement in connection with the land; or
- any other right, power or privilege over the land, or in connection with the land.

150. Paragraph 1.42 of the revised EM to the New Business Tax System (Capital Allowances) Bill 2001 explains that:

> Where the owner of the quasi-ownership right improves the land with a depreciating asset, or improves a depreciating asset that is itself an improvement to land, and where that improvement is for their own use but they *cannot* remove that asset from the land, they are nonetheless the holder while their quasi-ownership right exists.

151. This extract covers the scenario whereby a miner, holding a right to mine from a relevant government authority, establishes and improves an open pit mine site improvement to the land over which the right exists. The miner is treated as the holder of the depreciating asset, notwithstanding that the miner does not own the land to which the improvement has been made.

152. A subsequent miner would also be indentified as the holder of the pit, in a scenario where the ownership of the quasi-ownership right changed. The presence of the words, 'by any owner of the right' in column 2 of item 3 in the table in section 40-40 provides that the holder of a pit will be the new miner where the mining operation is directly acquired. This interpretation is supported by a plain reading of the words in item 3 and in accordance with the perceived policy intent of the capital allowance rules.

153. Where the miner owns the land to which the pit has been constructed, the miner will be identified as the holder of the pit under item 10 of the table in section 40-40 as the miner will be the legal owner of the depreciating asset.

The start time of a pit

154. Section 40-60 defines the start time of a depreciating asset to be when you first use it, or have it installed ready for use, for any purpose.

155. The words 'for any purpose' ensures that a start time can occur where the asset begins to be used for a non-taxable purpose. The revised EM to the New Business Tax System (Capital Allowances) Bill 2001 suggests this was the intention where it states:

> …It is irrelevant that the depreciating asset may first be used for a non-taxable purpose. The current law expressly refers to assets installed ready for use and held in reserve, but the express words are reproduced here, as an unused asset is not installed ready for use unless it is held in reserve. Conversely, an asset which begins to be used must be installed ready for use. There are some assets which by their nature cannot be installed. Their start time will occur once they begin to be used…[29]

156. A pit cannot be installed. Rather, it comes into being as a result of the removal of overburden and mineralised rock and the deliberate shaping of the land that enables the miner to carry on the extraction activity. The start time for a pit will therefore occur once the pit is 'in use'.

157. The Commissioner considers that a pit is being used from the time the pit is first used to further its own construction or to extract mineralised rock. Typically, this will be sometime after the vegetation and top soil above the hard rock has been removed.

A pit is being used for a taxable purpose from its start time

158. A depreciating asset's start time sets the time from which the asset begins to decline in value. Subsection 40-25(2) provides that a deduction in respect of that decline in value must be reduced by the part of the asset's decline in value that is attributable to a use of the asset for a purpose other than a taxable purpose.

159. It is therefore necessary to consider whether a pit is being used for a taxable purpose from its start time. The meaning of taxable purpose is set out in subsection 40-25(7) to include *the purpose of producing assessable income*. This phrase is further defined in subsection 995-1(1) as:

> something is done for the ***purpose of producing assessable income*** if it is done:
>
> (a) for the purpose of gaining or producing assessable income; or
>
> (b) in carrying on a *business for the purpose of gaining or producing assessable income.

[29] Paragraph 1.64.

160. This definition indicates there needs to be some connection with the use of the depreciating asset to the derivation of the assessable income of the holder of the asset, or to a business carried on for that purpose. A depreciating asset may be being used for the purpose of producing assessable income even though it does not of itself generate assessable income. It is sufficient that the depreciating asset contributes to the income producing activity or business of the holder.

161. In those circumstances, a pit is being used for a taxable purpose from its start time, as its use in providing a setting for further excavation is a necessary step in extracting the underlying mineral deposit.

162. The phrase 'for a purpose other than a taxable purpose' as it appears in subsection 40-25(2) is taken principally to mean a use of a depreciating asset for a private purpose or for the purpose of deriving exempt or non-assessable non-exempt income. The activity associated with the creation of a pit is a precursor to the derivation of assessable income that will happen once sufficiently mineralised rock begins to be extracted. There is a sufficient connection in this initial use of the pit to establish that the depreciating asset has commenced to be used for a taxable purpose.

The effective life of an open pit mine site improvement

163. The calculation of the decline in value of a depreciating asset for an income year is based on, among other things, its effective life. Subsection 40-95(1) provides that the holder of a depreciating asset must:

- use an effective life determined by the Commissioner under section 40-100; or
- itself work out the effective life under section 40-105.

164. Subsection 40-95(3) stipulates that the choice of determining an effective life must be made for the income year in which the asset's start time occurs.

165. In making a determination, subsection 40-100(4) instructs the Commissioner to consider the period during which the depreciating asset can be used by any entity for a taxable purpose. This instruction, together with the view as set out above that the entire open pit mine site improvement is a single depreciating asset, would support a determination that the effective life of the pit will typically equate to its planned and therefore predictable useful life. In a one pit mine, that would typically be expected to correspond to the estimated life of the mine.

166. Where a mine site has within its boundaries two or more separate and distinct open pits, each pit would constitute a separate depreciating asset. Each pit in this scenario will have its own effective life which will typically equate to the planned and therefore predictable useful life of that individual pit.

167. Subsection 40-110(1) provides that the effective life of a pit is able to be recalculated because of changed circumstances relating to the nature of use of the asset. For example, the miner may choose to recalculate the effective life of the pit where the mine plan is amended at some later time that results in a change of the mine life from what was envisaged when the initial estimate was made.

Establishing the cost of a depreciating asset that is a pit

168. The cost of a depreciating asset is worked out in Subdivision 40-C. Subsection 40-215(1) requires the cost of a depreciating asset to be reduced by amounts that are deductible or taken into account in working out a deduction under provisions other than Division 40, Division 41 or Division 328. Section 40-220 provides that the cost of a depreciating asset must be reduced by any portion of it that consists of an amount that is not of a capital nature.

169. Expenditure incurred in establishing a pit that is deductible under section 8-1 would not form part of the first element of the cost of the pit.

170. Further, any expenditure incurred in enlarging and improving a pit that is deductible under section 8-1 would not form part of the second element of the cost of the pit. Taxation Ruling TR 95/36[30] discusses the Commissioner's view as to extent of expenditure in establishing or expanding a pit that would be of a capital nature.[31]

An expansion of the pit can increase the cost of the depreciating asset

171. Paragraph 40-190(2)(a) operates such that expenditure incurred in expanding the pit via the push-back process is included in the second element of the pit's cost.[32] Paragraph 40-190(2)(a) is worded as follows:

> (a) the amount you are taken to have paid under section 40-185 for each economic benefit that has contributed to bringing the asset to it present condition and location from time to time since you started to hold the asset; and

172. The expenditure incurred in undertaking a pushback provides economic benefits to the miner in the sense that the expenditure contributes to the enhanced use of the pit.

---

[30] TR 95/36 *Income tax: characterisation of expenditure incurred in establishing and extending a mine*.
[31] Refer to paragraphs 59-75 of the Explanations.
[32] Subject, of course, to the operation of sections 40-215 and 40-220 (see paragraph 168).

A balancing adjustment event arises if the miner ceases to hold a pit that has a cost of nil

173. That an asset can have a nil cost as a result of the operation of section 40-215 or 40-220 does not prevent that asset from satisfying the conditions to be a depreciating asset as defined in section 40-30.

174. Once it is established a depreciating asset exists for which a start time has commenced, the holder of the asset must apply the relevant provisions in Subdivision 40-B that work out the decline in value of the asset. In respect of a pit, the holder has the choice to use either the diminishing value method or the prime cost method. Each method establishes the deduction for decline in value on the basis of the asset's cost.[33]

175. A condition that must be satisfied before a balancing adjustment event can arise is that the entity that held the depreciating asset worked out a decline in value for the asset under Subdivision 40-B. [34]

176. The Commissioner considers that a balancing adjustment amount arises where an open pit mine site improvement with a nil cost is disposed of as part of a direct sale of a mine site.

177. It is considered that Subdivision 40-B applies to work out the decline in value in a situation where the cost of a depreciating asset is nil. Subdivision 40-B contains the core capital allowance provisions that apply to work out the decline in value of all depreciating assets, irrespective of their cost. These core provisions are operative in that they require the holder of the depreciating asset to have worked out the asset's cost such that a deduction for decline in value can be ascertained.

178. Where the depreciating asset's termination value is more than its adjustable value[35] just before the balancing adjustment event occurred, an amount equal to the excess is included in the assessable income of the entity that held the asset. If the asset's cost is nil just before the balancing adjustment event, the amount of the excess that is included in the assessable income of the entity that held the asset will equal the asset's termination value; as the adjustable value of the asset will also be nil.

179. The meaning of termination value is provided in section 40-300. Where the open pit mine site improvement is disposed of as part of the direct sale of the mine site, the termination value of the pit will be that amount of the purchase price that is reasonably attributable to the asset.[36]

---

[33] For the diminishing value method, see sections 40-70 and 40-72. For the prime cost method, see section 40-75.
[34] Subparagraphs 40-285(1)(a)(i), 40-285(2)(a)(i) and 40-292(1)(a)(i).
[35] The adjustable value of a depreciating asset set by section 40-85.
[36] See paragraph 40-300(1)(b) and the link through that paragraph to Item 1 in the table in paragraph 40-305(1)(b).

A pushback does not trigger a balancing adjustment event

180. Section 40-115 applies when a depreciating asset is split into 2 or more assets. Subsection 40-115(2) provides that a split in a depreciating asset occurs just before the holder stops holding part of the asset. Splitting the asset in this way allows a balancing adjustment event to happen in respect of that part of the asset no longer held.

181. The Commissioner considers that subsection 40-115(2) does not apply as a consequence of a pushback. The destruction of structural elements of the pit is not considered to result in part of the pit not being held. The pushback process is more correctly viewed as altering the profile of an improvement to land that is a depreciating asset – something that occurs as the pit enlarges to enable the underlying mineral deposit to be mined out.

182. Further, the example contained in subsection 40-115(2) and the revised EM to the New Business Tax System (Capital Allowances) Bill 2001 support an interpretation that subsection 40-115(2) is principally intended to operate in situations where an interest in a depreciating asset is being disposed of. The revised EM provides that:

> When a taxpayer stops holding part of a depreciating asset because it is now held jointly they are considered to have split the original depreciating asset into an asset that is kept by the taxpayer and an asset that the taxpayer ceases to hold. In other words, when a taxpayer becomes a joint holder, because they give up an interest in a depreciating asset, they are taken to have split the underlying asset into new assets, that is, the interest retained and the interest given up. The normal balancing adjustment rules apply to the new asset that the taxpayer is taken to have stopped holding.[37]

The operation of the consolidation tax cost setting rules when an open pit miner joins a consolidated group[38]

183. The consolidation regime in Part 3-90 operates to treat wholly-owned corporate groups as a single entity for income tax purposes. This means that the subsidiary members of the group lose their individual income tax identity and are treated as parts of the head company during the period in which they are members of the group. The assets and liabilities of the subsidiary members are treated as assets and liabilities of the head company.

184. The consolidation regime contains tax cost setting rules that apply when an entity becomes a subsidiary member of the group. The purpose of these rules is to align the cost to the head company of acquiring the membership interests in the joining entity to the assets that the joining entity brings with it into the group.

---

[37] Paragraph 1.141.

[38] Reference to a consolidated group in this Explanation includes reference to a multiple entry consolidated group (a MEC group).

185. The tax cost setting rules contain supporting provisions that give meaning to the tax cost setting process and affect the subsequent income tax treatment of assets that are brought into the group by a subsidiary member, including what history relating to the asset is relevant to the head company.

186. The first step in applying the tax cost setting rules is to identify the assets the joining entity is bringing into the consolidated group.

A pit is an asset for Part 3-90 purposes

187. The concept of 'asset' is not defined by Part 3-90. Taxation Ruling TR 2004/13[39] provides the ATO view as to what is an asset for the purposes of the tax cost setting rules in Part 3-90.

188. TR 2004/13 provides for a wide view of the recognition of assets, stating that:

> …an asset for the purpose of the tax cost setting rules is anything recognised in commerce and business as having economic value to the joining entity at the joining time for which a purchaser of its membership interests would be willing to pay. The business or commercial assets of a joining entity would include the things that would be expected to be identified by a prudent vendor and purchaser as having value in the making of a sale agreement in respect of all the membership interests in an entity and its business.[40]

189. TR 2004/13 outlines further that:

> Assets recognised under the *Income Tax Assessment Act 1936* (ITAA 1936) and the ITAA 1997 would come within the ordinary commercial or business meaning of an asset for Part 3-90 of the ITAA 1997. Assets within these categories would include items of trading stock, revenue assets, traditional and qualifying securities, depreciating assets and CGT assets.[41]

190. Accordingly, a pit would be recognised as an asset of a joining entity holding the improvement to land upon joining a consolidated group, for the following reasons:

- geotechnical engineers view mine site improvements as assets of commercial and engineering value,
- the acquirer of a miner will often specifically recognise and pay for mine site improvements, as the presence of the pit prevents an opportunity cost referable to the time and expense necessarily required to extract the remaining mineral deposit in the absence of the pit, and
- an open pit mine site improvement is a depreciating asset for the purposes of Division 40.

---

[39] TR 2004/13 *Income tax: the meaning of an asset for the purposes of Part 3-90 of the Income Tax Assessment Act 1997*.
[40] at paragraph 5.
[41] at paragraph 11.

191. TR 2004/13 goes on to comment on the question as to whether a composite item or its component parts are to be recognised for Part 3-90 purposes:

> The extent and degree to which the assets of the entity should be separately identified or treated as composite items would depend on the nature of the asset and the business being carried on by the entity and the circumstances of the particular case.[42]

192. This indicates that the asset identified under the capital allowance rules would equate to the asset identified under the consolidation tax cost setting rules. As such, a tax cost setting amount will be established for the pit rather than any of the structural elements of the pit.

Treatment of the tax cost setting amount set for a pit

193. Subsection 701-10(4) provides that each asset of a joining entity is required to have its tax cost set at the joining time at the asset's 'tax cost setting amount'.

194. Item 1 in the table in subsection 701-60(1) instructs that the tax cost setting amount, where the asset's tax cost is set by section 701-10, is worked out in accordance with Division 705.

195. Subsection 701-10(3) provides that the object of Division 705 '...is to recognise the cost to the head company of such assets as an amount reflecting the group's cost of acquiring the entity'.

196. Further detail is provided in the Objects clauses to Subdivision 705-A in section 705-10 which state:

> …
>
> *Object*
>
> **(2)** The object of this Subdivision is to recognise the head company's cost of becoming the holder of the joining entity's assets as an amount reflecting the group's cost of acquiring the entity. That amount consists of the cost of the group's membership interests in the joining entity, increased by the joining entity's liabilities and adjusted to take account of the joining entity's retained profits, distributions of profits, deductions and losses.
>
> **(3)** The reason for recognising the head company's cost in this way is to align the costs of assets with the costs of membership interests, and to allow for the preservation of this alignment until the entity ceases to be a subsidiary member.

197. Paragraph 5.18 of the EM to the New Business Tax System (Consolidation) Bill (No. 1) 2002 confirms that:

> A joined group's cost of acquiring a joining entity is treated as the head company's cost of acquiring the assets of the joining entity.

---

[42] at paragraph 26 of the Explanation.

198. The cost of acquiring the joining entity that is then allocated to the joining entity's assets is established by working out an allocable cost amount (ACA) for the joining entity, which is an 8-step calculation as described in section 705-60.

199. The ACA is allocated to the assets of the joining entity by first allocating amounts to retained cost base assets. The remaining ACA is then allocated to the reset cost base assets of the joining entity in proportion to their market values.

200. Section 705-35 defines an asset to be a reset cost base asset if it is not a retained cost base asset.[43] This means that an open pit mine site improvement will be a reset cost base asset of the joining entity.

201. Section 701-55 provides the legislative meaning of setting the tax cost of a joining entity's assets in this way. The intention is that the head company uses the tax cost setting amount to determine the subsequent tax consequences that arise in respect of the asset. The exact meaning of the expression depends on which provisions of the income tax law are to subsequently apply to the asset. For example:

- if the trading stock provisions in Division 70 are to apply to the asset, subsection 701-55(3) applies to deem the head company to have held the trading stock from the start of the income year in which the joining time occurs and sets the value of that stock at that time at the asset's tax cost setting amount,
- if the CGT provisions in Part 3-1 or Part 3-3 subsequently apply to the asset, subsection 701-55(5) applies to replace the asset's cost base or reduced cost base at the joining time with the asset's tax cost setting amount.

202. The legislative meaning of setting the tax cost of depreciating assets is provided in subsection 701-55(2). That subsection states:

> *Depreciating asset provisions*
>
> **(2)** If any of Subdivision 40-A to 40-D, sections 40-425 to 40-445 and Subdivision 328-D, and sections 73BA and 73BF of the *Income Tax Assessment Act 1936*, is to apply in relation to the asset, the expression means that the provisions apply as if:
>
> (a) the asset were acquired at the particular time for a payment equal to its tax cost setting amount; and
>
> (b) at the time the same method of working out the decline in value were chosen for the asset as applied to it just before that time; and
>
> (c) where just before that time the prime cost method applied for working out the asset's decline in value and the asset's tax cost setting amount does not exceed the joining entity's terminating value for the asset – at that time an effective life were chosen for the asset equal to the remainder of the effective life of the asset just before that time; and

[43] Retained cost base assets are defined in section 705-25.

(d) where just before that time the prime cost method applied for working out the asset's decline in value and the asset's tax cost setting amount exceeds the joining entity's terminating value for the asset – the head company were required to choose at that time an effective life for the asset in accordance with subsections 40-95(1) and (3) and any choice of an effective life determined by the Commissioner were limited to one in force at that time; and

(e) where neither paragraph (c) nor (d) applies – at that time an effective life were chosen for the asset equal to the asset's effective life just before that time.

203. The effect of paragraph 701-55(2)(a) is to deem an acquisition of the depreciating asset by the head company for a payment equivalent to the asset's tax cost setting amount. In a scenario where the joining entity holds an open pit mine site improvement that is a depreciating asset, the effect of this deemed acquisition is as follows:

- the head company of the consolidated group is treated as holding the pit from the joining time,
- the head company of the consolidated group is taken to have acquired the pit at the joining time for a payment equal to the asset's tax cost setting amount. This amount becomes the first element of the cost of the pit for the head company under section 40-180, and
- the 'start time' under section 40-60 for the open pit mine site improvement will begin when the head company starts to use the pit, which practically is likely to be the joining time.

204. Paragraph 701-55(2)(b) limits the choice of the method of working out the decline in value to the method that applied to the asset just before the joining time. Where no method has been actually chosen just before the joining time, the head company is permitted to choose a method under section 40-65.[44]

205. The effective life set for the asset will depend on whether paragraph 701-55(2)(c), (d) or (e) applies. Where paragraph 701-55(2)(e) applies, the head company will be required to determine the effective life of the asset under subsection 40-95(1).

A balancing charge does not arise for the joining entity

206. A balancing adjustment event does not arise under either paragraph 40-295(1)(a) or (b) as a result of the subsidiary member ceasing to hold the asset at the joining time.

[44] See reasoning in ATO Interpretative Decision ATO ID 2011/51.

207. The single entity rule in section 701-1 operates to treat a subsidiary member as being a part of the head company. It does not operate to deem a disposal of the joining entity's assets such that a balancing adjustment event would trigger in respect of the depreciating assets of the joining entity. This interpretation is supported by the note to subsection 701-35(3), which states:

> **Note:** In the case of assets other than trading stock, the fact that the entity ceases to hold them when the single entity rule begins to apply to them would not constitute a disposal or other event having tax consequences for the entity.

Determining the market value of an open pit mine improvement

208. As outlined at paragraph 199 of this Ruling, the ACA remaining after amounts are allocated to retained cost base assets is spread across the reset cost base assets of the joining entity in proportion to their market values. The Commissioner recognises the difficulty in valuing an improvement to land that is statutorily separated from the land.

209. Where a miner who conducts an open pit mining operation joins a consolidated group, there is a need to establish what value ascribes to the mining right (that represents the net present value of the remaining mineral deposit covered by the right) and what value ascribes to the associated open pit mine site improvement.

210. The methodology applied in valuing these assets should resolve any overlapping market value by having regard to the appropriate market value of each asset.

211. Further, in looking to apply a depreciated replacement cost methodology in valuing the improvement, one needs to consider whether a simple application is wholly appropriate in the unusual circumstances presented in a case where the asset for which a market value is sought is a construct of the law, and in many respects lacking a market.

212. A most direct indicator of the market value of a unique asset is available if the asset has recently been acquired in the marketplace. It is apparent that the market value will be indicated by the cost, and this holds true for assets that are constructed. The buyer has made an expenditure wholly to acquire the asset. The asset has a value (certainly in the mind of the acquirer) in line with the amount of the expenditure. And even at a later time, the earlier acquisition on market can still afford a valid (though less precise) basis of market value if the cost amount was to be depreciated at an appropriate rate.

213. But such an approach is seriously compromised in the case of the valuation of a pit. There might be no problem in identifying the cost of the pit, but typically this expenditure would not have been made wholly to acquire the asset. Once the mineral deposit has been reached, many of the costs of building the pit are at the same time the costs of retrieval of the mineral deposit. Note that this does not necessarily mean that the value of the pit would be less than the total expenditure (this is not an apportionment issue), but it does mean that the miner may well not have made the total amount of the expenditure if the only advantage accruing to it was the pit, in the form in which it presents at the time relevant for the valuation. There is, in these kinds of cases, a serious decoupling of the identity that usually obtains as between what a taxpayer paid for an asset and what a taxpayer would have paid for (merely) the asset. It is the latter that provides the link to market value.

214. One response to the awkwardness in arriving at the market value of a pit is the notion of depreciated optimised replacement cost. This approach observes that a mature pit may comprise a part that is redundant, in the sense that it has been entirely worked out and that mining activity and pit development continues 'at the other end'. Optimised replacement cost assumes (1.) the existence of no pit, but (2.) the mineral deposit consists of only the part that still remains in the ground at the time for the market valuation of the pit. The optimised replacement cost is the minimum cost of obtaining equivalent access to the remaining deposit, and in a reasonably mature mine this would often be less than the actual cost (and *a fortiori* the replacement cost) of the presently existing pit.

215. But it should be borne in mind that an optimised cost is merely that – a cost. Nobody has chosen to pay such a cost, so there is no link with the market. Obversely it can readily be appreciated that one can incur much expenditure in the construction of an 'asset' that the market cares little for. More particularly, it can be appreciated if there is only a very small percentage of ore remaining, the value of ready access to it might be very much less than the cost of digging a new pit, however optimal. Optimised replacement cost may have some part to play in arriving at market value, though. If a purported market value of a pit arrived at by some other method were in excess of the optimised replacement cost, it may well be appropriate to see the optimised replacement cost as setting a cap on the market value amount.

Appendix 2 – Detailed contents list

216. The following is a detailed contents list for this Ruling:

References

Previous draft:

TR 2012/D3

Related Rulings/Determinations:

TR 94/11; TR 95/36;
TR 2004/13; TR 2006/10

Subject references:

- adjustable value
- allocable cost amount
- balancing adjustment event
- consolidated group
- consolidation
- consolidation – assets
- consolidation – market valuations
- continuing majority-owned entity
- cost of a depreciating asset
- decline in value
- depreciating assets
- first element of cost
- hold a depreciating asset
- improvement to land
- joining entity
- joining time
- quasi-ownership right
- reset cost base asset
- retained cost base asset
- second element of cost
- splitting a depreciating asset
- start time
- tax cost is set
- tax cost setting amount
- tax cost setting rules
- taxable purpose
- terminating value
- uniform capital allowances system

Legislative references:

- TAA 1953
- ITAA 1936
- ITAA 1997 2-35
- ITAA 1997 2-45
- ITAA 1997 8-1
- ITAA 1997 Div 40
- ITAA 1997 Subdiv 40-B
- ITAA 1997 40-25(1)
- ITAA 1997 40-25(2)
- ITAA 1997 40-25(7)
- ITAA 1997 40-25(7)(a)
- ITAA 1997 40-30
- ITAA 1997 40-30(1)
- ITAA 1997 40-30(1)(a)
- ITAA 1997 40-30(1)(c)
- ITAA 1997 40-30(2)
- ITAA 1997 40-30(3)
- ITAA 1997 40-30(4)
- ITAA 1997 40-40
- ITAA 1997 40-60
- ITAA 1997 40-65
- ITAA 1997 40-70
- ITAA 1997 40-72
- ITAA 1997 40-75
- ITAA 1997 40-75(1)
- ITAA 1997 40-75(2)(b)
- ITAA 1997 40-75(3)
- ITAA 1997 40-80
- ITAA 1997 40-85
- ITAA 1997 40-85(1)(b)
- ITAA 1997 40-85(1)(c)
- ITAA 1997 40-95(1)
- ITAA 1997 40-95(3)
- ITAA 1997 40-100
- ITAA 1997 40-100(4)
- ITAA 1997 40-105
- ITAA 1997 40-110(1)
- ITAA 1997 40-115
- ITAA 1997 40-115(2)
- ITAA 1997 Subdiv 40-C
- ITAA 1997 40-180
- ITAA 1997 40-190(2)(a)
- ITAA 1997 40-215
- ITAA 1997 40-215(1)
- ITAA 1997 40-220
- ITAA 1997 40-285
- ITAA 1997 40-285(1)(a)(i)
- ITAA 1997 40-285(2)(a)(i)
- ITAA 1997 40-292(1)(a)(i)
- ITAA 1997 40-295(1)(a)
- ITAA 1997 40-295(1)(b)
- ITAA 1997 40-300
- ITAA 1997 40-300(1)(b)
- ITAA 1997 40-305(1)(b)
- ITAA 1997 40-340
- ITAA 1997 Div 41
- ITAA 1997 Div 70
- ITAA 1997 70-10
- ITAA 1997 Pt 3-1
- ITAA 1997 Pt 3-3
- ITAA 1997 Div 328
- ITAA 1997 Pt 3-90
- ITAA 1997 Div 701
- ITAA 1997 701-1
- ITAA 1997 701-10
- ITAA 1997 701-10(3)
- ITAA 1997 701-10(4)
- ITAA 1997 701-35(3)
- ITAA 1997 701-55

- ITAA 1997 701-55(2)
- ITAA 1997 701-55(2)(a)
- ITAA 1997 701-55(2)(b)
- ITAA 1997 701-55(2)(c)
- ITAA 1997 701-55(2)(d)
- ITAA 1997 701-55(2)(e)
- ITAA 1997 701-55(3)
- ITAA 1997 701-55(5)
- ITAA 1997 701-60(1)
- ITAA 1997 Div 705
- ITAA 1997 Subdiv 705-A
- ITAA 1997 705-10
- ITAA 1997 705-25
- ITAA 1997 705-30(3)
- ITAA 1997 705-35
- ITAA 1997 705-60
- ITAA 1997 995-1(1)
- IT(TP)A 701A-1
- IT(TP)A 701A-10
- AIA 15AD
- AIA 15AD(b)

Case references:

- Brisbane City Council v. Valuer-General (Queensland) [1978] HCA 40; (1978) 140 CLR 41
- Campbell v. Deputy Federal Commissioner of Land Tax (NSW) (1915) 20 CLR 49
- Commonwealth of Australia v. Oldfield (1976) 133 CLR 612; (1976) 10 ALR 243
- Dampier Mining Co Ltd v. Federal Commissioner of Taxation 79 ATC 4469; (1979) 10 ATR 193
- Fisher v. Deputy Federal Commissioner of Land Tax (NSW) (1915) 20 CLR 242
- Keogh v. Deputy Federal Commissioner of Land Tax (NSW) (1915) 20 CLR 258
- McGeogh v. Federal Commissioner of Land Tax (1929) 43 CLR 277
- Mitsui & Co (Australia) Ltd v. FCT [2012] FCAFC 109
- Morrison v. Federal Commissioner of Land Tax (1914) 17 CLR 498

Other references:

- ATO ID 2003/489
- ATO ID 2007/11
- ATO ID 2007/12
- ATO ID 2007/13
- ATO ID 2007/14
- ATO ID 2011/2
- ATO ID 2011/51
- Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002
- Revised Explanatory Memorandum to the New Business Tax System (Capital Allowances) Bill 2001
- The Australian Concise Oxford Dictionary, 2004, 4th ed.
- The Macquarie Dictionary, 2001, revised third edition, The Macquarie Library Pty Ltd, NSW

ATO references

NO: 1-41CWK79
ISSN: 1039-0731
ATOlaw topic: Income Tax ~~ Capital allowances ~~ balancing adjustments – balancing adjustment event
Income Tax ~~ Capital allowances ~~ balancing adjustments – termination value
Income Tax ~~ Capital allowances ~~ cost of depreciating assets
Income Tax ~~ Capital allowances ~~ decline in value calculation
Income Tax ~~ Capital allowances ~~ effective life of a depreciating asset
Income Tax ~~ Capital allowances ~~ holder of a depreciating asset
Income Tax ~~ Capital allowances ~~ taxable purpose
Income Tax ~~ Capital allowances ~~ what is a depreciating asset?
Income Tax ~~ Consolidation ~~ assets
Income Tax ~~ Consolidation ~~ market value
Income Tax ~~ Consolidation ~~ tax cost setting amount