Division 40 v Division 43 Tax Depreciation

Presented by: Stephen Marsden
M.Bus (Acc), CPA, CA, CTA, MAICD.

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Outline

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1.0 General and specific deductions

1.1 Relationship between General and Specific Deductions

- Deductions are governed by Division 8 of the ITAA (1997). Division 8 refers to two categories of deductions:
  - Section 8-1: General Deductions; and
  - Section 8-5: Specific Deductions.
- Diagram 1 on the following slide summarises the tax equation showing the relationship between assessable income and deductions.

Diagram 1: The tax equation

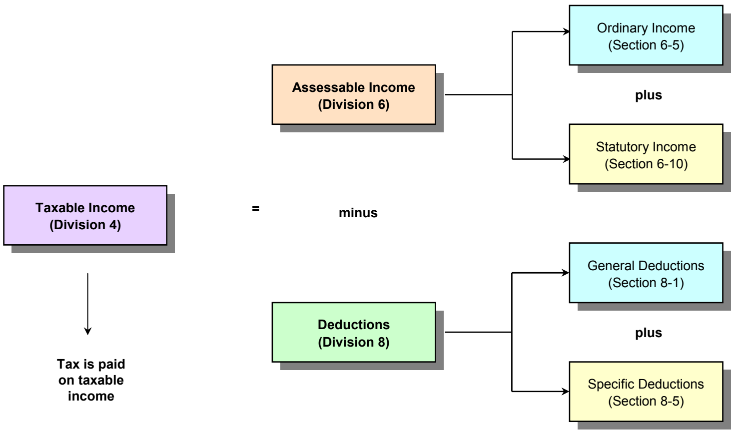
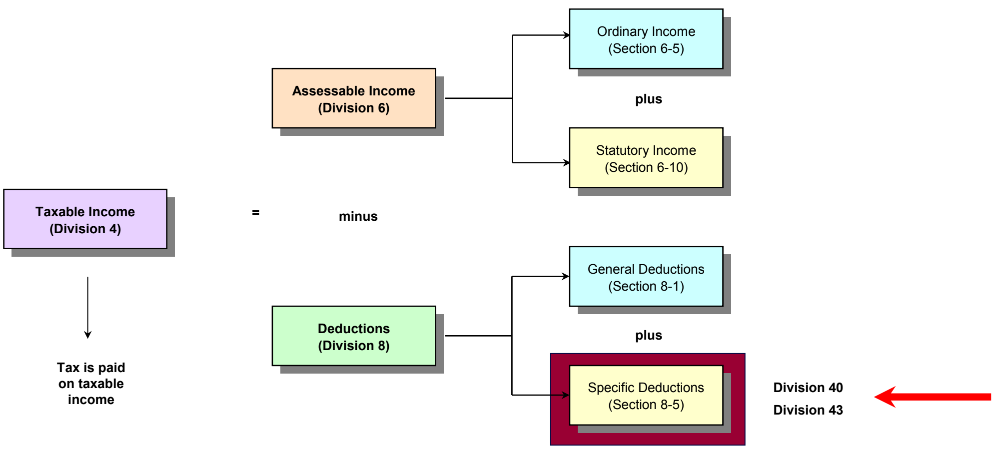


Diagram 1: The tax equation



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2.0 Division 40: Depreciating Assets

- Under Section 8-1(2)(a), a taxpayer is denied an immediate deduction for any outgoing of a capital nature. This is referred to as the second negative limb on Section 8-1.

- However, Division 40 of the ITAA (1997) allows a taxpayer a deduction for the decline in the value of a "depreciating asset" that is owned and used by a taxpayer in the course of gaining or producing assessable income.

- The key operative provision for depreciation is Section 40-25(1) of the ITAA (1997). It states:

  "You can claim an amount equal to the ***decline in value*** *for an income year of a depreciating asset that you held for any time during the year."*

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- Note the term "decline in value" means "depreciation".

- In order to claim a deduction for depreciation, the taxpayer must use the asset for income-producing purposes (Section 40-25(2)).

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2.1 Who is the Holder of a Depreciating Asset?

- A deduction for depreciation is available to the "holder" of a depreciating asset.

- In most cases, the legal owner is the holder of the asset. However, there are some exceptions to this rule. Section 40-40 contains a table detailing the entity that is treated as the holder of a depreciating asset.

- Co-owners must divide the income and expenses for the rental property in line with their 'interest' in the property.

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- The two co-owner structures are:

  - **Joint tenants** - each holds an equal interest in the property (ie. 50% each); or
  - **Tenants in common** - may hold unequal interests in the property, for example, one person may hold an ownership interest of 20% in the property and the other person holds 80%.

- Co-owned depreciating assets, as outlined in section 40-35 of the ITAA 1997, are able to be calculated and deducted based on each owner's interest in the asset, and not the whole asset.

- A taxpayer will usually stop holding a depreciating asset when they are no longer its legal owner.

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- For example, where a taxpayer sells a rental property, they will stop holding the fixtures and fittings (i.e. the depreciable assets) in the rental property as at the time the contract of sale settles.

- However, for CGT purposes, the taxpayer is taken to have disposed of the land and buildings (under CGT event A1) on the date that the contract was signed, and not settlement.

- As such, this means that the taxpayer must take into account different timings when apportioning the capital proceeds under the contract of sale between depreciable assets and the capital proceeds from the sale of the property (which is a CGT asset).

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2.2 What is a Depreciating Asset?

- According to Section 40-30(1), a "depreciating asset" is defined as an asset that has a limited effective life and can reasonably be expected to decline in value over the time it is used. This definition captures the meaning of plant (such as machinery).

- Most non-current assets are considered depreciable assets for tax purposes. However, land, trading stock (inventory) and several intangible assets, such as trademarks and brandnames are specifically excluded from the definition of a depreciating asset for tax purposes.

- Furthermore, buildings are ***not*** considered depreciable assets for taxation purposes under Division 40. Instead, a special claim for buildings (called "capital works allowance") can be made under Division 43 of the ITAA (1997). This will be discussed later in these slides.

Table 1: Differences in Division 40 v 43

Division	*Provision*
40	Depreciation of depreciating assets (eg. plant and equipment)
43	Capital works write-off of buildings and capital improvements

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2.3 Determining the Cost of a Depreciating Asset

- Paragraph 16 of *AASB 116 Property, Plant and Equipment* requires that the cost of an asset includes not only the original purchase price, but all incidental costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

- For taxation purposes, the decline in value of a depreciating asset is also calculated based on the “cost” of the depreciating asset. According to Section 40-175, the “cost” of a depreciating asset comprises:

  (a) **the first element** (Section 40-180) which consists of the initial purchase price; and

  (b) **the second element** (Section 40-190) which comprises those incidental costs incurred to bring the asset to its present condition and location.

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- The cost of a depreciating asset not only includes its purchase price, but also costs including customs duty, delivery costs, in-transit insurance, assembly and installation costs (see *Taxation Ruling* IT 2197).

- This is a similar concept for accounting purposes, where incidental costs are added to the cost of the asset in the Balance Sheet.

- It needs to be remembered that if the taxpayer is registered for GST (eg. a business), then the “cost” of the depreciating asset is its GST-exclusive cost. On the other hand, if the taxpayer is ***not*** registered for GST (such as a rental property owner), then the “cost” of the depreciating asset is its GST-inclusive cost.

- Furthermore, in the case of an individual taxpayer, even if they are personally registered for the GST (as a sole trader), they cannot claim back the GST on a rental property, as residential rent is input taxed under Division 40 of the GST Act (1999).

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2.4 Determining the Effective Life of a Depreciating Asset

(a) Accounting

- According to paragraph 50 of *AASB 116 Property, Plant and Equipment*, a depreciable asset must be systematically depreciated over its estimated useful life (expressed in years).

- The definition of useful life in paragraph 6 means the estimated period over which the future economic benefits are expected to be consumed ***by the entity***.

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(b) Taxation

- For taxation purposes, the decline in value of a depreciating asset is calculated under Division 40 of the ITAA (1997) based on the effective life ***of the asset*** (expressed in years).

- The question is: How does one determine the useful effective life of a depreciating asset for taxation purposes?

- According to Section 40-95(1), a taxpayer can determine the effective life of a depreciating asset:

  (a) self-assess and determine the effective life themselves (Section 40-105); or
  (b) rely on the Commissioners determination of effective life (Section 40-100).

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- This choice must be made at the assets "start-time" (Section 40-95(3)). This is the time that the asset is first used by the taxpayer for any purpose or is installed ready for use (Section 40-60(2)).

- An extract of the 2021 company income tax return is shown below.

9 Capital allowances - continued
For all depreciating assets

Did you recalculate the effective life for any of your assets this income year? **D** [ ] Print Y for yes or N for no.

Total adjustable values at end of income year **E** [ ] .00

9 Capital allowances
Depreciating assets first deducted in this income year

Intangible depreciating assets first deducted **A** [ ] .00

Other depreciating assets first deducted **B** [ ] .00

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- To assist taxpayers in determining the useful (or effective) lives of depreciable assets, in January 2001, the Commissioner published his determination of effective lives of depreciating assets.
- This listing is included in a taxation ruling which is updated and re-issued every year.
- The latest version, *Taxation Ruling* TR 2021/3, was issued by the Commissioner on 30 June 2021 and applies in respect of income years beginning on or after 1 July 2021.
- This 280-page ruling can be accessed at the ATO’s website.

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- The effective lives of depreciating assets are incorporated in Tables A and B.
- Table A is only to be used by members of the specified industries. These include industries such as agriculture, mining, manufacturing, retail trade, accommodation and food services, arts and recreation and education and training.
- Taxpayers not in those industries must use Table B.
- Table B is a list of common assets (eg rental property assets, cars, computers, etc) used by a broader range of taxpayers (including salary and wage earners).

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2.5 Calculating the Decline in the Value of Depreciating Assets

(i) Accounting

- According to paragraph 62 of AASB 116, there are three (3) acceptable methods of calculating depreciation.

- These are:

  (a) straight-line;
  (b) diminishing balance; and
  (c) units-of-production method.

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(ii) Taxation

- For taxation purposes, Section 40-65(1) permits only one of two methods in calculating the decline in the value of a depreciating asset:

  (a) the prime cost method (Section 40-75); or
  (b) the diminishing value method (Section 40-70).

Table 2: Accounting v Taxation terms

Accounting Term	*Taxation Term*
Straight line	Prime cost
Diminishing balance	Diminishing value
Units-of-production	N/A

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- A taxpayer may choose either the prime cost or diminishing value method for each depreciating asset.
- However, the choice of method for a particular asset applies for that income year and all later years in which the taxpayer claims a deduction for the decline in value of that asset (Section 40-130).
- In other words, for taxation law purposes, the taxpayer cannot change depreciation methods once a particular method is chosen.

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(a) The Prime Cost Method

- The prime cost method for taxation purposes is similar to the straight-line method for accounting purposes.
- The prime cost depreciation rate is calculated as dividing 100% by the effective life of the item.

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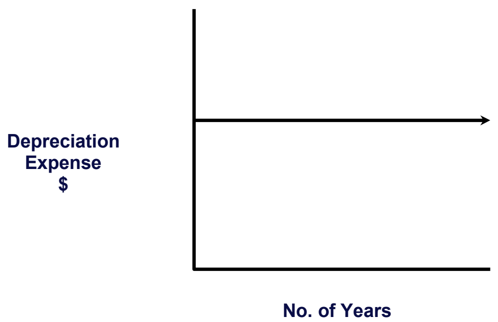
The Prime Cost Method



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- Where a depreciating asset is acquired during the income year, the amount of depreciation is calculated on a pro-rata basis from the date of acquisition to 30 June on a daily basis.

- The prime cost formula under Section 40-75 is shown as follows:

$$\textbf{Asset's cost} \times \frac{\textbf{Days held}}{\textbf{365}} \times \frac{\textbf{100\%}}{\textbf{Effective Life}}$$

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Example 1:

- A taxpayer purchases a photocopying machine costing $5,000 on 1 January 2021. According to TR 2021/3, the effective life of a photocopying machine is five (5) years. There are 181 days from 1 January 2021 to 30 June 2021.

- Calculate the decline in value (depreciation) of the photocopying machine for the years ended 30 June 2021 and 30 June 2022 under the prime cost depreciation method.

- Answer: ____________________

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Example 1 Answer:

2021:

$$\$5{,}000 \times \frac{181 \text{ days}}{365 \text{ days}} \times \frac{100\%}{5 \text{ years}} = \underline{\$496 \text{ (rounded)}}$$

2022:

$$\$5{,}000 \times \frac{365 \text{ days}}{365 \text{ days}} \times \frac{100\%}{5 \text{ years}} = \underline{\$1{,}000 \text{ (rounded)}}$$

Tax grouping	Total cost @ 14-Dec-16 ($) Based on 100%	Total cost @ 14-Dec-16 ($) Based on 25.00%	Effective life (Years)	Basic rate (PC)	Depreciation allowance					TWDV @ 1-Jul-21 ($)
					14-Dec-16 30-Jun-17 Year 1 ($)	1-Jul-17 30-Jun-18 Year 2 ($)	1-Jul-18 30-Jun-19 Year 3 ($)	1-Jul-19 30-Jun-20 Year 4 ($)	1-Jul-20 30-Jun-21 Year 5 ($)	
Division 40 - plant & equipment (Based on effective life rates)										
Additional unit specific										
Furniture - Freestanding B (19-Dec-19)	1,297	324	13	7.5%	0	0	0	13	24	287
Furniture - Freestanding A (27-May-20)	360	90	13	100.0%	0	0	0	90	0	0
Light Freestanding (27-May-20)	200	50	5	100.0%	0	0	0	50	0	0
Brushcutter (12-Jun-20)	379	95	5	100.0%	0	0	0	95	0	0
Clothes Dryers (13-Sep-20)	2,653	663	10	10.0%	0	0	0	0	53	610
Washing Machines (13-Sep-20)	2,354	589	8	12.5%	0	0	0	0	59	530
Furniture - Freestanding B (12-Nov-20)	3,784	946	13	7.5%	0	0	0	0	45	901
Furniture - Freestanding A (14-Nov-20)	1,760	440	13	7.5%	0	0	0	0	21	419
Rugs (14-Nov-20)	2,400	600	7	14.3%	0	0	0	0	54	546
Rugs (23-Nov-20)	1,200	300	7	100.0%	0	0	0	0	300	0
Furniture - Freestanding A (20-Dec-20)	1,100	275	13	100.0%	0	0	0	0	275	0
Furniture - Freestanding B (20-Dec-20)	2,730	683	13	7.5%	0	0	0	0	27	656
Light Freestanding (14-Jan-21)	719	180	5	100.0%	0	0	0	0	180	0
Smoke Alarms (28-Jan-21)	382	96	6	100.0%	0	0	0	0	96	0
Furniture - Freestanding B (31-Jan-21)	3,509	877	13	7.5%	0	0	0	0	27	850
Subtotal	24,827	6,208			0	0	0	248	1,161	4,798
Total division 40 - plant	24,827	6,208			0	0	0	248	$\boxed{1{,}161}$	4,798

The above table of figures are calculated using the ownership percentage of 25.00% per cent.

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(b) The Diminishing Value Method

- The diminishing value method for taxation purposes equates to the diminishing balance method for accounting purposes.

- The diminishing value method involves applying a percentage rate initially to the original cost of the item, but subsequently to the base value (ie. written down value) at the commencement of each year thereafter.

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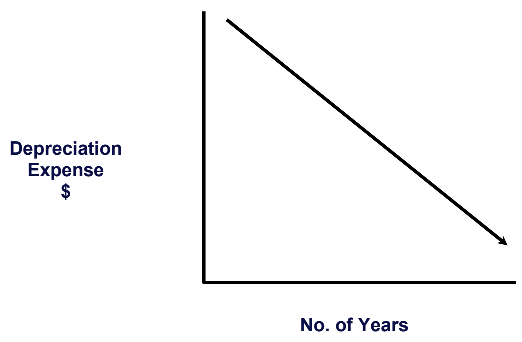
The Diminishing Value Method



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- The diminishing value formula under Sections 40-70 and 40-72 is shown as follows:

$$\textbf{Base Value of Asset (WDV)} \times \frac{\textbf{Days held}}{\textbf{365}} \times \frac{\textbf{200\%}}{\textbf{Effective Life}}$$

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Example 2:

- Assume the same facts Example 1.
- Calculate the decline in value (depreciation) of the photocopying machine for the years ended 30 June 2021 and 30 June 2022 under the diminishing value depreciation method.
- Answer: ______________________

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Example 2 Answer:

2021:

$$\$5{,}000 \times \frac{181 \text{ days}}{365 \text{ days}} \times \frac{200\%}{5 \text{ years}} = \underline{\$992 \text{ (rounded)}}$$

2022:

Base Value (or WDV) = ($5,000 - $992) = $4,008

$$\$4{,}008 \times \frac{365 \text{ days}}{365 \text{ days}} \times \frac{200\%}{5 \text{ years}} = \underline{\$1{,}603 \text{ (rounded)}}$$

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Table 3: Comparison of Tax Depreciation Methods

Income Year	*Prime Cost Depreciation*	*Diminishing Value Depreciation*
2021	$496	$992
2022	$1,000	$1,603
2023	$1,000	$962
2024	$1,000	$577
2025	$1,000	$346
2026	$504	$520
Total:	**$5,000**	**$5,000**

Diminishing value method schedule (years 1 - 5)

Tax grouping	Total cost @ 14-Dec-16 ($) Based on 100%	Total cost @ 14-Dec-16 ($) Based on 25.00%	Effective life (Years)	Basic rate (DV)	Depreciation allowance					TWDV @ 1-Jul-21 ($)
					14-Dec-16 30-Jun-17 Year 1 ($)	1-Jul-17 30-Jun-18 Year 2 ($)	1-Jul-18 30-Jun-19 Year 3 ($)	1-Jul-19 30-Jun-20 Year 4 ($)	1-Jul-20 30-Jun-21 Year 5 ($)	
Division 40 - plant & equipment (Based on effective life rates)										
Additional unit specific										
Furniture - Freestanding B (19-Dec-19)	1,297	324	13	37.5%	0	0	0	0*	0	164
Furniture - Freestanding A (27-May-20)	360	90	13	100.0%	0	0	0	90	0	0
Light Freestanding (27-May-20)	200	50	5	100.0%	0	0	0	50	0	0
Brushcutter (12-Jun-20)	379	95	5	100.0%	0	0	0	95	0	0
Clothes Dryers (13-Sep-20)	2,653	663	10	37.5%	0	0	0	0	0*	539
Washing Machines (13-Sep-20)	2,354	589	8	37.5%	0	0	0	0	0*	479
Furniture - Freestanding B (12-Nov-20)	3,784	946	13	37.5%	0	0	0	0	0*	769
Furniture - Freestanding A (14-Nov-20)	1,760	440	13	37.5%	0	0	0	0	0*	357
Rugs (14-Nov-20)	2,400	600	7	37.5%	0	0	0	0	0*	487
Rugs (23-Nov-20)	1,200	300	7	100.0%	0	0	0	0	300	0
Furniture - Freestanding A (20-Dec-20)	1,100	275	13	100.0%	0	0	0	0	275	0
Furniture - Freestanding B (20-Dec-20)	2,730	683	13	37.5%	0	0	0	0	0*	555
Light Freestanding (14-Jan-21)	719	180	5	100.0%	0	0	0	0	180	0
Smoke Alarms (28-Jan-21)	382	96	6	100.0%	0	0	0	0	96	0
Furniture - Freestanding B (31-Jan-21)	3,509	877	13	37.5%	0	0	0	0	0*	713
Subtotal	24,827	6,208			0	0	0	235	851	4,062
Total division 40 - plant	24,827	6,208			0	0	0	235	851	0
Total division 40 - pooled plant (Page 19)	0	0			0	0	0	61	998	4,063
Total division 40	24,827	6,208			0	0	0	296	$\boxed{1,849}$	4,062

*Low cost assets and low value assets have been allocated to the low value pooling table.

The above table of figures are calculated using the ownership percentage of 25.00% per cent.

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2.6 Special Rules Relating to Different Types of Taxpayers

- Special rules relating to the decline in value of depreciating assets apply to various categories of taxpayers.
- These taxpayers are split into:

  (a) individual taxpayers;
  (b) small business entities (SBE);
  (c) medium-sized entities (turnover between $10 million and $5 billion) – not covered in this webinar; and
  (d) large business entities (turnover of more than $5 billion) – not covered in this webinar.

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2.6.1 Individual Taxpayers

- The depreciation rules for individual taxpayers are summarised as follows:

(a) according to Section 40-80(2), an immediate 100% deduction applies in respect of depreciating assets **costing $300 or less** used by non-business taxpayers in deriving assessable income.

(b) for depreciating assets costing **more than $300 but less than $1,000**, there are two options available:

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(i) Firstly, the assets may be allocated to a low-value pool and depreciated at the following rates:

- 18.75% DV in the first year; and
- 37.5% DV in the second and subsequent years.

Once a low-value pool has been created, then all depreciable capital assets costing between $300 and $1,000 must be allocated to that low-value depreciation pool and the business must continue to use the low-value pool method until all value in that pool has been diminished. In other words, once an item is allocated into this low-value pool, it must remain there.

(ii) Secondly, if the taxpayer elects not to use a low-value pool, then the normal depreciation rules as contained in (c) below apply.

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(c) depreciating assets **costing $1,000 or more** are depreciated over their effective lives as outlined by the Commissioner in *Taxation Ruling* TR 2021/3 using either the prime cost or diminishing value depreciation methods.

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Three Advantages of pooling:

- Firstly, there is no need to self-assess the individual effective life of each depreciating asset or refer to the effective life of each individual asset as per *Taxation Ruling* TR 2021/3. If a taxpayer has multiple depreciable assets, this could prove to be very time consuming as each asset has a different effective life for tax purposes.

- Secondly, there is no need to calculate the number of ownership days as there is no need to apportion the depreciation for the number of days in the initial ownership year ie from the date of purchase to 30 June in that first year.

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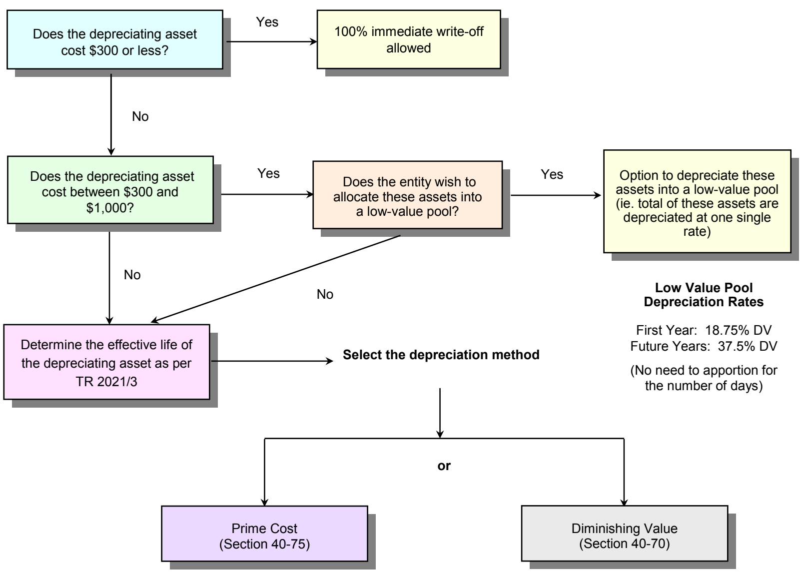
- Thirdly, only two depreciation rates need to be used. One rate for depreciating assets purchased during the income year (being 18.75%), and a second rate for assets held since the end of the prior income year (ie. 37.5%).
- The main disadvantage of pooling is that the asset loses its individual identity in the pool. What is depreciated is the total of the asset pool and not the individual assets themselves.
- Many owners/directors want to know the original cost and written down values of individual assets that their entity owns. This information is often required for internal business management purposes.
- Diagram 1 on the following slide summarises the depreciation rules for individual taxpayers.



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Example 3:

- Hannah, an individual taxpayer, works as a journalist for a newspaper. During the 2022 income year, she purchased the following assets for exclusive use for her job:

Item	*Date*	*Asset*	*No. Days*	*TR 2020/3 Effective Life*	*Amount*
(a)	*7 September 2020*	*Portable laser printer*	*297*	*5 years*	*$240*
(b)	*19 February 2021*	*Multi-function machine*	*132*	*5 years*	*$880*
(c)	*2 May 2021*	*Desktop computer*	*60*	*4 years*	*$1,200*

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Example 3:

- Calculate Hannah's decline in value (depreciation) claim in respect of the abovementioned assets for the year ended 30 June 2022.
- Assume that Hannah wishes to maximise any depreciation deduction claimed in 2022.
- Answer: ______________________

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Example 3 Answer:

(a) The portable laser printer cost $240. As this amount is less than $300, Hannah can claim the entire amount of **$240** as a tax deduction under Section 40-80(2) of the ITAA (1997).

(b) The multi-function machine cost $880. As this amount is between $300 and $1,000, Hannah has the choice of depreciating the asset using the effective life of 5 years (as per Table B of TR 2021/3) and apportion for the number of days to 30 June 2021, or allocate the asset to a low-value pool and depreciate it at the rate of 18.75% DV in the first year (with no apportionment for the number of days).

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Pooling:

$880 x 18.75% DV = **$165 (rounded)**

Depreciation as per TR 2021/3:

$$\$880 \times \frac{132 \text{ days}}{365 \text{ days}} \times \frac{200\%}{5 \text{ years}} = \$127 \text{ (rounded)}$$

As pooling gives the greater deduction, Hannah should pool the multi-function machine.

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(c) In terms of the desktop computer, as this amount is more than $1,000, it must be depreciated in accordance with the Commissioner's effective life of 4 years as per Table B of TR 2021/3.

The decline in value of the desktop computer is calculated as follows:

$$\$1{,}200 \times \frac{60 \text{ days}}{365 \text{ days}} \times \frac{200\%}{4 \text{ years}} = \boxed{\$99 \text{ (rounded)}}$$

- Hannah's total depreciation claim comes for 2022 to **$504** (ie. $240 + $165 + $99)

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2.6.2 Small Business Entity (SBE) Taxpayers

- There are special depreciation rules contained in Division 328-D of ITAA 1997 which are available to small business entity (SBE) taxpayers.

- According to Section 328-110 of the ITAA (1997), for the year ended 30 June 2022, a business is classified as a "small business entity" if:

  - it carries on business in that year; and
  - its aggregated turnover for the year is **less than $10 million**.

- An entity's annual turnover for an income year is the total ordinary income that the entity derives in the income year in the ordinary course of carrying on a business.

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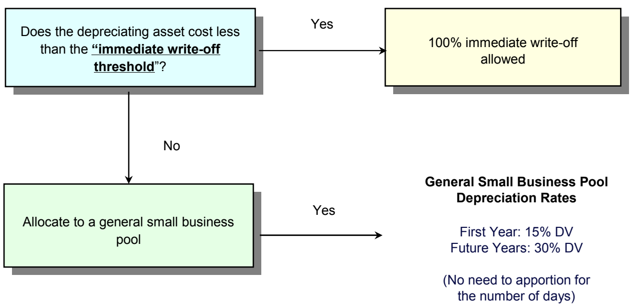
- There are two components of these SBE simplified depreciation concessions:
  - an instant write-off for certain “low cost” assets, and
  - the ability to group all other depreciable assets into a “small business pool” for simpler calculations.
- If a small business elects to adopt these simplified depreciation rules, then it must apply both of these rules to all its depreciating assets and keep on doing so for the life of those assets.
- If a small business chooses not to use these special depreciation rules, then it must use the depreciation rules for large business entities.
- Diagram 2 on the following slide summarises the depreciation rules for SBE taxpayers.

Diagram 2: Depreciation rules for SBE’s



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- The “immediate write-off threshold” (also known as the “instant write-off threshold”) for ”low cost” assets depends on when the depreciating asset was acquired.
- A summary of the relevant thresholds are summarised in Table 2 on the following slide.

Table 2: Immediate Write-Off Thresholds

Date of Acquisition of Depreciating Asset	*Immediate Write-off Threshold*	*Annual SBE Turnover*
Before 12 May 2015 (7:30 pm)	$1,000	< $2 million
12 May 2015 (7:30 pm) to 28 January 2019	$20,000	< $10 million
29 January 2019 to 2 April 2019 (7:30 pm)	$25,000	< $10 million
After 7:30 pm on 2 April 2019 to 11 March 2020	$30,000	< $10 million
After 12 March 2020 to 6 October 2020	$150,000	< $10 million
6 October 2020 to 30 June 2023	Unlimited	< $10 million
After 1 July 2023	$1,000	< $10 million

2.0 Division 40: Depreciating assets

Temporary Full Expensing of Eligible Depreciating Assets

- On 6 October 2020, in the Federal Budget, the federal government announced that SBE's will be able to claim an immediate deduction for the full (uncapped) cost of an eligible depreciating asset purchased on or after 7.30 pm on 6 October 2020 until 30 June 2023.
- This is what is referred to as "temporary full expensing".
- As a result of the temporary full expensing rules and the fact that there is no instant asset write-off threshold, SBE's can claim the full cost of an eligible capital asset purchased.

2.0 Division 40: Depreciating assets

Depreciation Car Cost Limit of $60,733 - All Taxpayers

- In the case of motor vehicles, Section 40-230 of the ITAA (1997) imposes a car cost limit, which effectively limits the amount of depreciation a taxpayer can claim.
- For the year ended 30 June 2022, the depreciation car cost limit is $60,733 (2021: $59,136).
- In other words, if a car costs $125,000, the SBE can only claim an immediate deduction up to the car cost limit of $60,733 limit, and not $125,000.
- No deduction can be claimed for any amount in excess of $60,733.

2.0 Division 40: Depreciating assets

General Small Business Pool Rules

- Where the cost of a deprecating asset costs more than the “immediate write-off threshold” outlined in Table 2, then the SBE is required to pool (ie. lump) these depreciating assets and depreciate them in a general small business pool at the diminishing value rate of 30% per year (15% DV in the first year).

- Once the balance of this pool has decreased below the immediate write-off threshold, the balance can be fully written off in the subsequent income tax year.


10 Small business entity simplified depreciation

Deduction for certain assets **A** .00

Deduction for general small business pool **B** .00

2.0 Division 40: Depreciating assets

2.7 Residential Rental Properties and New Depreciation Rules after 9 May 2017

- Prior to 9 May 2017, a purchaser of a residential rental property would allocate a portion of the purchase price to depreciating assets purchased with the property and claim depreciation deductions under Div 40 of the ITAA 1997.

- This created opportunities for successive investors to ‘refresh’ the value of previously used depreciating assets and claim amounts in excess of their actual value or even original cost, resulting in a ‘double dip’ of claims for tax purposes across successive owners of the assets.

- The *Treasury Laws Amendment (Housing Tax Integrity) Act 2017* which received Royal Assent on 30 November 2017 addressed this issue by amending Division 40 to limit deductions to outlays actually incurred by investors.

2.0 Division 40: Depreciating assets

- The changes outlined in Section 40-27(2) mean that an individual investor who exchange contracts to acquire a residential rental property after 7.30pm AEST on 9 May 2017 from a previous owner (ie. 'second-hand property') will ***not*** be entitled to claim Division 40 depreciation from 1 July 2017 for existing depreciable assets in that property.

- These rules do not apply where an individual investor acquires a second-hand residential rental property before 7.30pm on 9 May 2017.

- This means that the investor can generally continue to claim depreciation for existing depreciable assets in that property.

2.0 Division 40: Depreciating assets

- The changes do ***not*** affect:

  - New residential rental properties (including investors who purchase a brand new property from a builder or 'off the plan');
  - Residential properties used in the course of carrying on a business (eg. a taxpayer operating a hotel can deduct the decline in value of depreciating assets used for the purposes of the business in the hotel premises);
  - Division 40 depreciation claims for new assets (eg. furniture, chattels, etc.) subsequently purchased (for any residential rental property) by the current owner of the property; and
  - Commercial properties.

- Lastly, the changes do not affect an investor's ability to claim the Division 43 capital works allowance.

2.0 Division 40: Depreciating assets

Lost Depreciation = Capital Loss on Sale of the Rental Property

- Depreciation on any existing equipment, fixtures and fittings at the second-hand investment property purchased after 7:30 pm on 9 May 2017 that are ***not*** deductible, may result in a capital loss when the property is sold.
- The amount of the capital loss is the amount of depreciation that could not be claimed by the owner as a result of these changes.
- A capital loss may also include a depreciable asset that was scrapped as part of the sale of the property.

2.0 Division 40: Depreciating assets

Example 4:

- On 5 September 2021, Emily acquired an two-bedroom apartment that she intends to rent. This apartment was built in 2014 and has previously been rented.
- When purchasing the apartment, Emily purchased a number of depreciating items, including carpets, blinds, a washing machine, a hot water system and a cooktop that were purchased by the previous owner.
- She also puts a refrigerator that she bought three years ago that she has been using in her home in the rental property for the tenant’s use, as she recently bought a new refrigerator.
- Soon after tenants have moved into the property, Emily installs new blinds (depreciable assets).

2.0 Division 40: Depreciating assets

Example 4 Answer:

- The amendments do ***not*** permit Emily to deduct an amount under Division 40 for the decline in value of the depreciable items (including the carpets, blinds, washing machine, hot water system and a cooktop) that she bought from the previous owner. These assets have been 'previously used'.
- The refrigerator is also considered a second-hand asset as it has been 'previously used'. Hence, no depreciation is permitted on this asset even though Emily owned these assets.
- The amendments do not affect Emily's entitlement to deduct an amount under Division 40 for the decline in value of the new blinds. They are not 'previously used', and as such, are 'new' depreciable assets. Emily is entitled to a deduction for depreciation on the new blinds.

3.0 Division 43: Capital Works Allowance

3.0 Division 43: Deduction for Capital Works Expenditure

- As previously mentioned, for taxation purposes, a taxpayer is ***not*** entitled to claim depreciation in respect of income-producing buildings under Division 40 of the ITAA (1997).
- However, Division 43 allows a taxpayer to claim a deduction for capital works expenditure incurred on the ***original construction cost*** of income-producing buildings and other capital works.

3.0 Division 43: Capital Works Allowance

- Whilst the term “capital works” is not defined, Division 43 applies to:

  - buildings;
  - structural (capital) improvements;
  - environmental protection earthworks; and
  - extensions, alterations or improvements to any of the above items (for example, refurbishment of a kitchen or bathroom to a rental property owned by a taxpayer).

- The Division 43 write-off is not based on the purchase price of the building, but on its original “construction expenditure”.

3.0 Division 43: Capital Works Allowance

- Construction expenditure includes:

  - the original construction costs of the building or capital improvement;
  - preliminary expenses such as architect’s fees; engineering fees and costs associated with obtaining approval for the building; and
  - the cost of structural features that are an integral part of the building (eg. retaining walls, fences, atriums and lift wells).

3.0 Division 43: Capital Works Allowance

- However, according to Section 43-70, construction expenditure does ***not*** include costs incurred in:
  - acquiring the land;
  - clearing the land prior to construction;
  - demolishing existing structures;
  - pre-construction site clearance (eg clearing, levelling, filling or draining); and
  - landscaping.
- It is important to note that the deduction is not based on the cost to the taxpayer, but on the original construction cost.
- **The question is how does one determine the original construction cost?**

3.0 Division 43: Capital Works Allowance

- *Taxation Ruling* TR 97/25 states that where the taxpayer is unable to precisely determine the actual cost of construction, the ATO will accept estimates from:
  - a clerk of works (ie. a project manager for major building projects);
  - a supervising architect who approves payments at each stage in major projects or smaller contracts;
  - a builder who is experienced in estimating costs of similar building projects; or
  - quantity surveyors.

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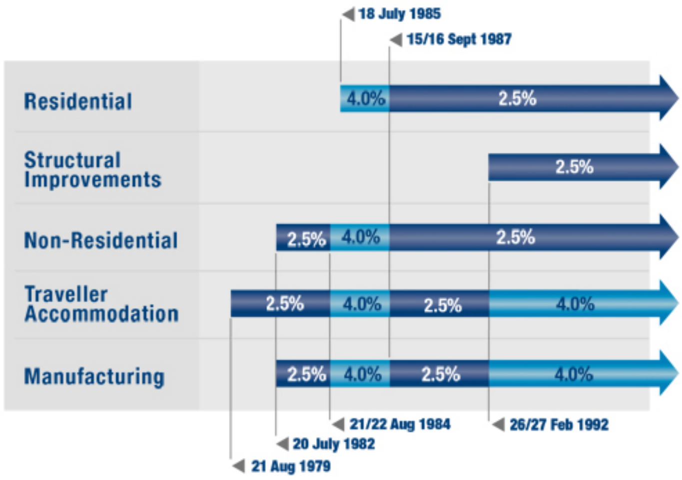
3.0 Division 43: Capital Works Allowance

- Real estate valuers, estate agents, accountants and solicitors will not be accepted unless they have other relevant qualifications.
- The rate of the deduction depends on the year in which the construction commenced in addition to the type of use of the building and/or capital works.
- The applicable rates of deduction are shown in Table 3 on the following slide.

Table 3: Division 43 Rates

Type of Construction	*Start of Construction*	*Years*	*Deduction Rate*
Industrial buildings	After 26 February 1992	25	4.0%
Short-term traveller accommodation (eg. backpackers and youth hostels)	22 August 1979 to 21 August 1984	40	2.5%
	22 August 1984 to 15 September 1987	25	4.0%
	16 September 1987 to 26 February 1992	40	2.5%
	After 26 February 1992	25	4.0%
Other residential accommodation (eg. residential units, apartments, flats, houses)	18 July 1985 to 15 September 1987	25	4.0%
	After 15 September 1987	40	2.5%
Other non-residential buildings (eg. commercial premises)	20 July 1982 to 21 August 1984	40	2.5%
	22 August 1984 to 15 September 1987	25	4.0%
	After 15 September 1987	40	2.5%
Structural Improvements	After 26 February 1992	40	2.5%
Environmental protection earthworks	After 18 August 1992	40	2.5%

Diagram 1: Division 43 Rates



3.0 Division 43: Capital Works Allowance

- Unlike Division 40, where the taxpayer can elect to use either the prime cost or diminishing value method, under Division 43 only the **prime cost method** can be used.

- Like depreciation, the calculation under Division 43 (at either 2.5% or 4%) needs to be performed on a daily basis starting from (and, therefore including) the first date that the property was used to derive assessable income.

3.0 Division 43: Capital Works Allowance

Division 43 – capital works allowance (Ownership percentage 25.00% per cent)

The table below outlines the division 43 building write-off allowance available to be claimed over forty years from the construction completion date. The depreciation calculated has been deemed to be on structural elements only completed after the legislated dates.

Works	Date	Rate	Original cost ($)	Split cost ($)
Original works	15-Nov-14	2.5%	453,005	113,251
Additional works	3-May-17	2.5%	148	37
Additional works	19-May-17	2.5%	222	56
Additional works	22-May-17	2.5%	603	151
Additional works	12-Feb-18	2.5%	8,395	2,099
Additional works	10-Dec-18	2.5%	11,099	2,775
Additional works	3-Jun-20	2.5%	298	75
Additional works	24-Jan-21	2.5%	552	138
Additional works	28-Jan-21	2.5%	520	130

3.0 Division 43: Capital Works Allowance

Division 43 – capital works allowance (Ownership percentage 25.00% per cent)

The table below outlines the division 43 building write-off allowance available to be claimed over forty years from the construction completion date. The depreciation calculated has been deemed to be on structural elements only completed after the legislated dates.

Period	Original division 43 ($)	Split division 43 ($)
1-Jul-19 to 30-Jun-20	11,838	2,959
1-Jul-20 to 30-Jun-21	11,855	2,964
1-Jul-21 to 30-Jun-22	11,871	2,968
1-Jul-22 to 30-Jun-23	11,871	2,968
1-Jul-23 to 30-Jun-24	11,871	2,968
1-Jul-24 to 30-Jun-25	11,871	2,968
1-Jul-25 to 30-Jun-26	11,871	2,968
1-Jul-26 to 30-Jun-27	11,871	2,968
1-Jul-27 to 30-Jun-28	11,871	2,968

3.0 Division 43: Capital Works Allowance

Example 5:

- On 13 April 2022, Charlene acquires a two-bedroom apartment in Brisbane city for $600,000. She immediately rents this property out to tenants at $620 per week.
- Based on a quantity surveyors report, she is advised that the apartment was built by Mirvac in March 2010. The original construction cost of her two-bedroom apartment was $200,000.
- Calculate Charlene's capital works allowance claim for the year ended 30 June 2022 under Division 43.
- Answer: ____________________

3.0 Division 43: Capital Works Allowance

Example 5 Answer:

- Charlene is entitled to an annual tax deduction of $5,000 per year under Division 43. This is based on the original construction cost of $200,000 divided by 40 years.
- However, for the year ended 30 June 2021, Charlene's Division 43 claim is prorated for the number of days from 13 April 2022 to 30 June 2022 (being 79 days).
- Her claim for 2021 therefore comes to **$1,082** (based on $5,000 x 79/365 days).

3.0 Division 43: Capital Works Allowance

- If the two-bedroom apartment came furnished (eg. carpets, blinds, curtains, dishwasher, washing machine, lounge, chairs and tables etc), these items constitute depreciable items.
- Charlene will be entitled to a depreciation claim for these items under the depreciation rules contained in Division 40.

3.0 Division 43: Capital Works Allowance

Example 6:

- On 9 October 2021, Ace High Pty Ltd acquires a property (consisting of a large block of land and a commercial office building) for an amount of $3.6 million.
- The company engaged a quantity surveyor to determine the breakdown of the costs relating to the property. The quantity surveyor's report reveals the following cost information:

	$
• Cost of land	300,000
• Demolition of old building on original site (April 2001)	10,000

3.0 Division 43: Capital Works Allowance

	$
• Pre-construction site clearance (May 2001)	20,000
• Construction of new building (August 2001)	400,000
• Landscaping (March 2004)	4,000

- The company leased the commercial office building to tenants on 21 October 2021. It was rented out to tenants from 21 October 2021 to 30 June 2022 inclusive (which equates to 253 days).

Required:

- Calculate Ace High Ltd's deduction for capital works expenditure for the year ended 30 June 2022.

3.0 Division 43: Capital Works Allowance

Example 6 Answer:

- In the case of a commercial office building, this building is defined as "other non-residential buildings". As construction of the building was in August 2001, the appropriate capital works deduction is the rate of 2.5 per cent over a 40-year period.

- In terms of the construction costs, the only cost that is eligible for the Division 43 capital works expenditure write-off is the construction of the building of $400,000.

- All other amounts are specifically excluded under Section 43-70(2) of the ITAA (1997).

3.0 Division 43: Capital Works Allowance

- Hence, the Division 43 annual claim is calculated as $10,000 per annum (being $400,000 x 2.5%). However, the claim for the 2021 income year needs to be apportioned for the number of days that the property was used to derive assessable income (ie. from 21 October 2021 to 30 June 2022).

- Hence, the company's Division 43 claim for the 2022 income year is calculated as follows:

$$\$400{,}000 \quad \times \quad \frac{253 \text{ days}}{365 \text{ days}} \quad \times \quad 2.5\% \quad = \quad \underline{\$6{,}932}$$

4.0 Distinction between Div 40 and Div 43

Distinction between Division 40 and Division 43

- In practice, the distinction between Division 40 (depreciation) and Division 43 (capital works allowance) is a difficult one to differentiate in practice.

- Table 4 on the following slide provides some practical guidelines in determining whether a capital asset qualifies for deduction under Division 40 or Division 43?

Table 4: Division 40 v Division 43

Date	*Division 40 Depreciation*	*Division 43 Capital Works Allowance*
1. Can the item of property in question be easily removed and taken with the taxpayer without damaging the item?	Yes	No
2. Is the item of property permanently affixed to the building and form part of the building?	No	Yes
3. Is the item of property specifically listed in *Taxation Ruling* TR 2021/3?	Yes	No

Div 40 v Div 43 – Outdoor

Asset	*Division 40 Depreciation*	*Division 43 Capital Works Allowance*
1. Garden hose		
2. Fencing		
3. Outdoor deck		
4. Solar panels		
5. Gutters and downpipes		

Div 40 v Div 43 – Lounge Room

Asset	Division 40 Depreciation	Division 43 Capital Works Allowance
1. Ceiling fan		
2. Ducted air conditioning		
3. Split cycle airconditioning		
4. Blinds		
5. Tiles fixed to the floor		

Div 40 v Div 43 – Kitchen

Asset	Division 40 Depreciation	Division 43 Capital Works Allowance
1. Down lights		
2. Kitchen cupboards		
3. Vinyl floor planks		
4. Refrigerator		
5. Rangehood		

Div 40 v Div 43 – Bathroom

Asset	*Division 40 Depreciation*	*Division 43 Capital Works Allowance*
1. Toilet		
2. Exhaust fan		
3. Bath		
4. Vanity		
5. Taps		

Summary of capital expenditure

The following summary of capital expenditure is based on 100 per cent ownership ratio.

Purchase price	$943,275
Expenditure after purchase	$87,873
Total expenditure	$1,031,148
Division 43 – capital works allowance total as at 14 December 2016	$429,455
Division 43 – original capital works allowance total	$453,005
Division 43 – capital works allowance total as at 1 July 2019	$420,601
Division 40 – plant and equipment	$24,827
Balance of capital expenditure	$513,820

This represents all items included in the purchase price that do not qualify for capital works deductions or decline in value and any capital works deductions which are already exhausted.

Prime cost method summary (Ownership percentage 25.00%)

Date	Division 40	Division 43	Total
14-Dec-16 to 30-Jun-17	0	1,545	1,545
1-Jul-17 to 30-Jun-18	0	2,857	2,857
1-Jul-18 to 30-Jun-19	0	2,928	2,928
1-Jul-19 to 30-Jun-20	248	2,959	3,207
1-Jul-20 to 30-Jun-21	1,161	2,964	4,125
1-Jul-21 to 30-Jun-22	471	2,968	3,439
1-Jul-22 to 30-Jun-23	471	2,968	3,439
1-Jul-23 to 30-Jun-24	471	2,968	3,439
1-Jul-24 to 30-Jun-25	471	2,968	3,439
1-Jul-25 to 30-Jun-26	471	2,968	3,439
1-Jul-26 to 30-Jun-27	471	2,968	3,439
1-Jul-27 to 30-Jun-28	415	2,968	3,383
1-Jul-28 to 30-Jun-29	323	2,968	3,291
1-Jul-29 to 30-Jun-30	311	2,968	3,279
1-Jul-30 to 30-Jun-31	261	2,968	3,229
1-Jul-31 to 30-Jun-32	246	2,968	3,214

Diminishing value method summary (Ownership percentage 25.00%)

Date	Division 40 plant	Division 40 pooled plant	Total division 40	Total division 43	Total
14-Dec-16 to 30-Jun-17	0	0	0	1,545	1,545
1-Jul-17 to 30-Jun-18	0	0	0	2,857	2,857
1-Jul-18 to 30-Jun-19	0	0	0	2,928	2,928
1-Jul-19 to 30-Jun-20	235	61	296	2,959	3,255
1-Jul-20 to 30-Jun-21	851	998	1,849	2,964	4,813
1-Jul-21 to 30-Jun-22	0	1,523	1,523	2,968	4,491
1-Jul-22 to 30-Jun-23	0	951	951	2,968	3,919
1-Jul-23 to 30-Jun-24	0	595	595	2,968	3,563
1-Jul-24 to 30-Jun-25	0	374	374	2,968	3,342
1-Jul-25 to 30-Jun-26	0	233	233	2,968	3,201
1-Jul-26 to 30-Jun-27	0	145	145	2,968	3,113
1-Jul-27 to 30-Jun-28	0	91	91	2,968	3,059
1-Jul-28 to 30-Jun-29	0	58	58	2,968	3,026
1-Jul-29 to 30-Jun-30	0	36	36	2,968	3,004
1-Jul-30 to 30-Jun-31	0	22	22	2,968	2,990
1-Jul-31 to 30-Jun-32	0	14	14	2,968	2,982

Thank you