Guide to depreciating assets

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2001–02

TAXPACK REFERRED PUBLICATION

SIMPLER DEPRECIATION RULES APPLY TO BUSINESS TAXPAYERS IN THE SIMPLIFIED TAX SYSTEM—SEE PAGE 25 FOR MORE INFORMATION.

NAT 1996—6.2002

Australian Taxation Office

How self-assessment affects most individuals

Self-assessment means the Australian Taxation Office (ATO) uses the information you give on your tax return to work out your refund or tax bill. You are required by law to make sure you have shown all your assessable income and claimed only the deductions and tax offsets to which you are entitled.

What are your responsibilities?

Even if someone else—including a tax agent—helps you to prepare your tax return, you are still legally responsible for the accuracy of the information.

What if you lodge an incorrect tax return?

Our systems continually check for missing or wrong information. We have audit programs designed to detect where taxpayers have not declared all their assessable income or where they have incorrectly claimed deductions or tax offsets. If you become aware that your tax return is incorrect, you must contact us straightaway.

Initiatives to complement self-assessment

There are a number of initiatives administered by the ATO which complement self-assessment. Examples include:

- a change in penalty provisions so that if you take reasonable care with your tax affairs, you will not receive a penalty for honest mistakes—but please note that a general interest charge on omitted income or overclaimed deductions and tax offsets could still be payable
- private rulings
- your entitlement to interest on early payment or overpayment of a tax debt
- the process of applying for an amendment if you find you left something out of your tax return.

Do you need to ask for a private ruling?

If you have a concern about the way a tax law applies to your personal tax affairs, you may want to ask for a private ruling.

A private ruling will relate just to your situation. Write to the ATO describing your situation in detail and ask for advice. To do this, complete an *Application for a private ruling for individuals*. If you lodge your tax return before you receive your private ruling, be aware that the ruling may alter the accuracy of your tax return.

The ATO publishes on its website all private rulings issued. What we publish will not contain anything which could identify you.

You can ask for a review of a private ruling decision if you disagree with it, even if you have not received your assessment. Details of the review procedures are sent to you when the private ruling decision is made. For more information on private rulings, visit the ATO website at <**www.ato.gov.au**>.

Publications

To get any publication referred to in this book:

- visit our website at <**www.ato.gov.au**>
- ring our Publications Distribution Service on **1300 720 092** for the cost of a local call or
- visit an ATO office or ATO*access* site.

Publications referred to in this book include:

- *Application for a private ruling for individuals* (NAT 4106—3.2001)
- *Capital allowances schedule 2002* (NAT 3424—6.2002)
- *Capital allowances schedule instructions* (NAT 4089—6.2002)
- *Information for primary producers* (NAT 1712—6.2002)
- *Guide to capital gains tax* (NAT 4151—6.2002)
- *Research and development tax concession schedule and instructions* (available only on the ATO website or at ATO*access* sites)
- *Taxation Ruling IT 2685—Income tax: depreciation*
- *Taxation Ruling TR 2000/18—Income tax: depreciation effective life*
- *The Simplified Tax System—a guide for tax agents and small businesses* (NAT 6459—6.2002).

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Guide to depreciating assets 2001–02

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About this publication

This publication is available free from the Australian Taxation Office (ATO). The ATO prohibits any party from selling it. We regularly revise our publications to take account of changes to the law.

If you have an enquiry relating to your circumstances which this publication does not cover, ring the Personal Tax Infoline on **13 2861** or get help from a tax adviser.

As part of our commitment to produce accurate publications, taxpayers will not be subject to penalties if they can demonstrate that they based a tax claim on wrong information supplied by the ATO.

Contents

Deductions for the cost of depreciating assets

Under income tax law, you are allowed to claim certain deductions for expenditure incurred in gaining or producing assessable income—for example, in carrying on business. Some expenditure, such as the cost of acquiring capital assets, is generally not deductible.

The value of a capital asset which provides a benefit over a number of years declines over its effective life. In recognition of this fact, the cost of capital assets used in gaining assessable income can be written off over a period of time as tax deductions.

Before 1 July 2001, the cost of **plant** (for example, cars and machinery) and software was written off as **depreciation** deductions.

From 1 July 2001, the uniform capital allowance system (UCA) applies to most **depreciating assets**, including plant and in-house software. Under the UCA, deductions for the cost of a depreciating asset are based on the **decline in value** of the asset.

This publication covers how to work out the decline in value of your depreciating assets and what happens when you dispose of or stop using a depreciating asset. It also looks at the deductions available under the UCA for capital expenditure other than on depreciating assets.

The uniform capital allowance system

The UCA provides a set of general rules that applies across a variety of depreciating assets and certain capital expenditure. It does this by consolidating a range of former capital allowance regimes. These regimes were complex and inconsistent, and involved significant replication of parallel but not identical provisions and concepts. Most of these deficiencies are overcome by consolidating capital allowance provisions, including those relating to:

- plant
- software
- mining and quarrying
- intellectual property
- spectrum licences
- forestry roads and buildings.

The UCA maintains the treatment of some depreciating assets and capital expenditure such as certain primary production depreciating assets and capital expenditure. It also introduces new deductions for types of capital expenditure that did not previously attract a deduction, such as certain business and project related costs—refer to **Capital expenditure deductible under the UCA** on page 22 for more information.

Deductions for the cost of your depreciating assets, including those acquired before 1 July 2001, are now worked out using the UCA rules. You can deduct an amount for the **decline in value** of a **depreciating asset** you **hold** to the extent that you use it for a **taxable purpose**.

However, eligible taxpayers who elect to enter the Simplified Tax System (STS) will generally calculate deductions for their depreciating assets under the STS rules—see **STS taxpayers** on page 25.

Overview

Under the UCA, there are a number of steps in working out your deduction for the decline in value of a depreciating asset:

Is your asset a depreciating asset covered by the UCA?—see **What is a depreciating asset?** on page 2

Yes

Do you hold the depreciating asset?—see **Who can claim deductions for the decline in value of a depreciating asset?** on page 3

Yes

Has the depreciating asset started to decline in value?—see **When does a depreciating asset start to decline in value?** on page 5

Yes

What method will you use to work out decline in value?—see **Methods of working out decline in value** on page 5

What is the effective life of the depreciating asset?—see **Effective life** on page 10

What is the cost of your depreciating asset?—see **The cost of a depreciating asset** on page 12

Must you reduce your deduction for any non-taxable use?—see **Decline in value of depreciating asset used for non-taxable purpose** on page 8

Some of these steps do not apply:

- if you choose to allocate an asset to a pool
- if you can claim an immediate deduction for the asset
- to certain primary production assets
- to some assets used in rural businesses

—see **Working out decline in value** on page 4.

Glossary

The UCA introduces a number of new terms and concepts, and adopts some from the former capital allowance provisions. All these terms are explained in this publication and compared with those used in the former depreciation rules in the table below:

Former depreciation rules	UCA
Plant	Depreciating asset
Own	Hold
Cost	First element and second element of cost
Luxury car limit	Car limit
Income-producing use	Taxable purpose
–	Start time
Depreciation	Decline in value
Undeducted cost	Adjustable value

Depreciating asset—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—see **What is a depreciating asset?** in the next column.

Hold—Only a holder of a depreciating asset may deduct an amount for its decline in value. In most cases, the legal owner of a depreciating asset will be its holder—see **Who can claim deductions for the decline in value of a depreciating asset?** on page 3.

First element of cost—The first element of cost is, broadly, the amount paid (money and/or the market value of property given) or the amount taken to have been paid to hold the asset. It includes any additional amounts you spend on transporting the asset or installing it in position. It is worked out at the time you begin to hold the asset—see **The cost of a depreciating asset** on page 12.

Second element of cost—The second element of cost is the amount paid (money and/or the market value of property given) or the amount taken to have been paid to bring the asset to its present condition and location at any time, such as a cost of improving the asset. It is worked out after you begin to hold the asset—see **The cost of a depreciating asset** on page 12.

Car limit—If the first element of cost of a car exceeds the car limit for the income year in which you start to hold it, that first element of cost is reduced to the car limit. The car limit is $55 134 for this income year—see **Car limit for certain motor vehicles** on page 13.

Taxable purpose—Taxable purpose means for the purpose of producing assessable income. It also means for the purposes of exploration or prospecting and of mining site rehabilitation, and for environmental protection activities.

Start time—A depreciating asset's start time is when you first use it, or install it ready for use, for any purpose, including a private purpose—see **When does a depreciating asset start to decline in value** on page 5.

Decline in value—Deductions for the cost of a depreciating asset are based on the decline in value of the asset. For most depreciating assets, you have the choice of 2 methods to work out the decline in value of a depreciating asset: the prime cost method and the diminishing value method—see **Methods of working out decline in value** on page 5.

Adjustable value—A depreciating asset's adjustable value at a particular time is its cost (first and second elements) less any decline in value up to that time.

What is a depreciating asset?

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. Depreciating assets include such items as computers, electric tools, furniture and motor vehicles.

Land and items of trading stock are specifically excluded from being depreciating assets.

Most intangible assets are also excluded from being depreciating assets. Only the following intangible assets are specifically included as depreciating assets:

- in-house software—see **In-house software** on page 20 for more information
- certain items of intellectual property (patents, registered designs, copyrights and licences of these)
- mining, quarrying or prospecting rights and information
- certain indefeasible rights to use an international telecommunications submarine cable system
- spectrum licences
- datacasting transmitter licences.

Improvements to land or fixtures on land—for example, windmills and fences—are treated as separate from the land regardless of whether they can be removed or not and may be depreciating assets.

In most cases, it will be clear whether or not something is a depreciating asset. If you are not sure, contact your professional adviser or the Australian Taxation Office (ATO).

Depreciating assets excluded from the UCA

Deductions in relation to certain types of depreciating assets are not worked out under the UCA. These are:

- depreciating assets in relation to which deductions are available under the specific film provisions

- depreciating assets that are capital works—for example, buildings and structural improvements for which deductions would be available under the separate provisions for capital works (or would have been deductible had the expenditure been incurred or the works started at specified times)
- cars where you use the 'cents per kilometre' method or the '12 per cent of original value' method for calculating car expenses, methods which take the decline in value into account in their calculation
- indefeasible rights to use an international telecommunications submarine cable system if the expenditure was incurred or the system was used for telecommunications purposes at or before 11.45 a.m. [by legal time in the Australian Capital Territory (ACT)] on 21 September 1999.

Who can claim deductions for the decline in value of a depreciating asset?

Only a **holder** of a depreciating asset may deduct an amount for its decline in value.

In most cases, the legal owner of a depreciating asset will be its holder.

There may be more than one holder of a depreciating asset—for example, joint legal owners of a depreciating asset are all holders of that asset. Each person's interest in the asset is treated as if it were itself the depreciating asset. Each would work out their deduction for decline in value according to their interest—for example, at the cost of the interest to them, not the cost of the asset itself—and according to their use of the asset.

In certain circumstances, the holder is not the legal owner. Some of these cases are discussed below.

If you are not sure whether you are the holder of a depreciating asset, contact your professional tax adviser or the ATO.

Leased luxury cars

A leased car, either new or second hand, is a luxury car if its cost exceeds the car limit that applies for the income year in which the lease commences. The car limit for 2001–02 is $55 134—see **Car limit for certain motor vehicles** on page 13.

A luxury car lease (other than a genuine short-term hire arrangement) entered into after 7.30 p.m. (by legal time in the ACT) on 20 August 1996 is treated as a notional sale and loan transaction.

The cost or value of the car specified in the lease (or, if the parties were not dealing at arm's length, the amount that could reasonably have been expected to have been paid to purchase the car) is taken to be the cost of the car to the lessee and the amount loaned by the lessor to the lessee to buy the car.

In relation to the notional loan transaction, the actual lease payments are divided into notional principal and finance charge components. That part of the finance charge component applicable for the particular period (the 'accrual amount') is deductible to the lessee.

In relation to the notional sale transaction, the lessee is treated as the holder of the luxury car and is entitled to claim a deduction for the decline in value of the car. For the purpose of calculating the deduction, the cost of the car is limited to the car limit for the year in which the lease is granted.

Any deduction would be reduced to reflect any use of the car other than for a taxable purpose, such as private use.

If the lessee does not actually acquire the car from the lessor when the lease terminates, the lessee is treated under the rules as disposing of the car by way of sale to the lessor. This constitutes a balancing adjustment event and any assessable or deductible balancing adjustment amount for the lessee must be determined—see **What happens if you no longer hold or use a depreciating asset?** on page 14.

Depreciating assets subject to hire purchase agreements

For income tax purposes, certain hire purchase agreements entered into after 27 February 1998 are treated as notional sale and notional loan transactions.

Generally, the cost or value of the goods stated in the hire purchase agreement (or, if the parties were not dealing with each other at arm's length, the amount the notional buyer could reasonably have been expected to pay to buy the goods under an arm's length sale) is taken to be the cost of the goods to the hirer (the notional buyer) and the amount loaned by the financier (the notional seller) to the hirer to buy the goods. If the goods are depreciating assets, this same amount is taken to be the first element of cost for the purposes of calculating any deduction for decline in value. It would be subject to cost adjustments, including the car limit—see **The cost of a depreciating asset** on page 12.

In relation to the notional loan, the periodic payments are separated into principal and interest, the interest being deductible to the hirer.

In relation to the notional sale, the hirer is treated as the owner of the goods. Under the UCA rules, if the goods are depreciating assets, the hirer is the holder and is able to claim a deduction for decline in value if the asset is used for a taxable purpose—see **When does a depreciating asset start to decline in value?** on page 5.

If the hirer acquires the goods under the agreement, the hirer continues to be treated as the owner. Actual transfer of legal title to the goods from the financier to the hirer is not treated as a disposal or acquisition.

On the other hand, if the hirer does not legally acquire the goods under the arrangement, the goods are treated as being sold back to the financier at their market value at that time. This constitutes a balancing adjustment event for the hirer and an assessable or deductible balancing adjustment amount may arise—see **What happens if you no longer hold or use a depreciating asset?** on page 14.

The notional loan amount under a hire purchase agreement is treated as limited recourse debt—see **Limited recourse debt arrangements** on page 18.

Leased depreciating assets fixed to land

If you are the lessee of a depreciating asset and it is affixed to your land, under property law you become the legal owner of the asset. As the legal owner you are taken to hold the asset. However, an asset may have more than one holder. Despite the fact that the leased asset is affixed to your land, if the lessor of the asset (often a bank or finance company) has a right to recover it, then they too are taken to hold the asset as long as they have that right to recover it. You and the lessor—each being a holder of the depreciating asset—would calculate the decline in value of the asset based on the cost to each of you.

EXAMPLE

Holder of leased asset fixed to land

Jo owns a parcel of land. A finance company leases some machinery to Jo who installs it on her land and pays the installation costs. Under the lease agreement, the finance company has a right to recover the machinery if Jo defaults on her lease payments.

The finance company holds the machinery as it has a right to remove the machinery from the land. The finance company is entitled to deductions for the decline in value of the machinery based on the cost of the machinery to it. However, Jo also holds the machinery as it is attached to her land. She is entitled to a deduction for the decline in value based on the cost to her to hold the machinery. This would not include her lease payments but would include the cost of installing the machinery—see The cost of a depreciating asset on page 12 for more information about what amounts form part of the cost of a depreciating asset.

Depreciating assets which improve or are fixed to leased land

If a depreciating asset is fixed to leased land and the lessee has a right to remove it, they are the holder while the right to remove the asset exists.

EXAMPLE

Holder of depreciating asset fixed to leased land

Jo leases land from Bill who owns the land. Jo purchases some machinery and fixes it to the land. Under property law the machinery is treated as part of the land so Bill is its legal owner.

However, under the terms of her lease, Jo can remove the machinery from the land at any time. Because she has acquired and fixed the machinery to the land and has a right to remove it, Jo holds the machinery as long as the right to remove it exists.

If a lessee or owner of certain other rights over land (for example, an easement) improves the land with a depreciating asset, they are the holder of the asset if the asset is for their own use even though they have no right to remove it from the land. They remain the holder as long as the lease or right exists.

EXAMPLE

Holder of depreciating asset which improves leased land

Jo leases land from Bill to use for farming. Jo installs an irrigation system on the land which is an improvement to the land. While Bill is the legal owner under property law as the irrigation system is part of his land, Jo holds the irrigation system and, even though she has no right to remove it under her contract with Bill, she may deduct amounts for its decline in value for the term of the lease because:

- **she improved the land**
- **the improvement is for her use.**

Partnership assets

The partnership and not the partners or any particular partner is taken to be the holder of a partnership asset regardless of its ownership. A partnership asset is one held and applied by the partners exclusively for the purposes of the partnership and in accordance with the partnership agreement.

Working out decline in value

From 1 July 2001, deductions for the decline in value of most depreciating assets, including those acquired before that date, are worked out under the UCA rules.

The UCA contains general rules for working out the decline in value of a depreciating asset and those rules are covered in this part of the guide. (Transitional rules apply to depreciating assets held before 1 July 2001 to enable their decline in value to be worked out using these rules—see **Depreciating assets held before 1 July 2001** on page 7.)

The general rules do not apply to some depreciating assets. For these assets, the UCA provides specific rules for working out deductions:

- there is an immediate deduction for certain depreciating assets which cost $300 or less that are used predominantly to produce assessable income that is not income from carrying on a business—see **Immediate deduction for certain depreciating assets costing $300 or less** on page 9
- the decline in value of certain depreciating assets that cost or are written down to less than $1000 can be worked out through a low-value pool—see **Low-value pools** on page 18
- for in-house software, expenditure allocated for deduction to a software development pool—see **Software development pools** on page 20
- for depreciating assets used in exploration or prospecting, the decline in value is the asset's cost—see **Mining and quarrying and minerals transport** on page 24
- for the decline in value of certain depreciating assets used in primary production—see **Primary production depreciating assets** on page 21—and for capital expenditure incurred by primary producers and other landholders used in landcare operations, electricity connections or telephone lines—see **Capital expenditure of primary producers and other landholders** on page 22.

There are specific rules for working out deductions for depreciating assets used in carrying on research and development activities—see the *Research and development tax concession schedule and instructions* for more information.

When does a depreciating asset start to decline in value?

The decline in value of a depreciating asset starts when you first use it, or install it ready for use, for any purpose including a private purpose. This is known as a depreciating asset's **start time**.

Although an asset is treated as declining in value from its start time, a deduction for its decline in value is only allowable to the extent it is used for a taxable purpose. **Taxable purpose** means for the purpose of producing assessable income. It also means for the purposes of exploration or prospecting and of mining site rehabilitation, and for environmental protection activities.

If you initially use an asset for a non-taxable purpose, such as for private purposes, and in later years use it for a taxable purpose, you need to work out the asset's decline in value from its start time through the years it was used for a private purpose before you can work out your deductions for the decline in value of the asset in the years it is used for a taxable purpose—see **Decline in value of depreciating asset used for non-taxable purpose** on page 8 for information about deductions for the decline in value of depreciating assets used partly for non-taxable purposes.

EXAMPLE

Start time of a depreciating asset

Paul purchased a car on 1 July 2001 and immediately used it wholly for private purposes. He started a new business on 1 March 2002 and then used the car wholly in his business.

Paul's car started to decline in value from 1 July 2001 as that is the time he first used it. Paul can only deduct an amount equal to the decline in value in relation to the period commencing 1 March 2002 when the car was used for a taxable purpose.

Methods of working out decline in value

As with the depreciation rules, you have the choice of 2 methods to work out the decline in value of a depreciating asset: the prime cost method and the diminishing value method.

You can choose to use either method for each depreciating asset you hold. Once you have chosen a method for a particular asset, you cannot change to the other method for that asset.

In some cases, you do not have to make the choice because you can deduct the asset's cost—for example, certain depreciating assets which cost $300 or less—see **Immediate deduction for certain depreciating assets costing $300 or less** on page 9. In other cases, you do not have a choice of which method you use to work out the decline in value:

- for specified intangible depreciating assets—in-house software, certain items of intellectual property, spectrum licences and datacasting transmitter licences—you must use the prime cost method
- you must use the same method as an associate has used if you acquire a depreciating asset from an associate who has deducted, or can deduct, amounts for the decline in value of the asset—see **Depreciating asset acquired from an associate** on page 8
- you must use the same method the former holder has used if you acquire a depreciating asset but the user of the asset does not change or is an associate of the former user (for example, under sale and leaseback arrangements)—see **Holder changes but user same or associate of former user** on page 9.

Both the diminishing value and prime cost methods are based on a depreciating asset's effective life—the rules for working out an asset's effective life are explained in **Effective life** on page 10.

Calculation of the decline in value allows you to determine the adjustable value of a depreciating asset. A depreciating asset's **adjustable value** at a particular time is its first element and second element of cost (first and second elements) less any decline in value up to that time. Adjustable value is similar to the concept of undeducted cost used in the depreciation rules. The **opening adjustable value** of an asset for an income year is the same as its adjustable value at the end of the previous income year.

The decline in value and adjustable value of a depreciating asset are calculated from the start time independently of your use of the depreciating asset for a taxable purpose. However, your deduction for the decline in value is reduced to the extent your use of the asset is not for a taxable purpose—see **Decline in value of depreciating asset used for non-taxable purpose** on page 8. Your deduction may also be reduced if the depreciating asset is a leisure facility or boat even though the asset is used, or installed ready for use, for a taxable purpose—see **Decline in value of leisure facilities and boats** on page 8.

The **diminishing value method** assumes that the decline in value each year is a constant proportion of the remaining value and produces a progressively smaller decline over time. The formula is:

$$\text{Base value} \times \frac{\text{days held}}{365} \times \frac{150\%}{\text{asset's effective life}}$$

For the income year in which an asset's start time occurs, the **base value** is the asset's cost. For a later income year, the base value is the asset's opening adjustable value plus any amounts included in the asset's second element of cost for that year.

EXAMPLE

Base value [ignoring any goods and services tax (GST) impact]

Leo purchases a computer for $6000. The computer's base value in its start year is its cost of $6000. If the computer's decline in value for that year is $1000 and no amounts are included in the second element of cost of the computer, its base value for the next income year is its opening adjustable value of $5000, being its cost of $6000 less its decline in value of $1000.

Days held is the number of days you held an asset in an income year in which you used it or had it installed ready for use for any purpose. If the income year is the one in which the asset's start time occurs, you work out days held from its start time. If a balancing adjustment event occurs for the asset during the income year (for example, if you sell it), you work out days held up until the day the balancing adjustment event occurred—see **What happens if you no longer hold or use a depreciating asset?** on page 14 for information on balancing adjustment events.

EXAMPLE

Diminishing value method (ignoring any GST impact)

Laura purchased a photocopier on 1 July 2001 for $1500. The asset started to be used on the day of its purchase and has an effective life of 5 years. Laura chooses to use the diminishing value method to work out the decline in value of the photocopier. The decline in value of $450 for the 2001–02 income year is worked out as follows:

$$1500 \times \frac{365}{365} \times \frac{150\%}{5}$$

If Laura used the photocopier wholly for taxable purposes in that income year, she is entitled to a deduction equal to the decline in value. The adjustable value of the asset at 30 June 2002 would be $1050. This is the cost of the asset ($1500) less its decline in value up to that time ($450).

The **prime cost method** assumes that the value of a depreciating asset decreases uniformly over its effective life. The formula for the prime cost method is:

$$\text{Asset's cost} \times \frac{\text{days held}}{365} \times \frac{100\%}{\text{asset's effective life}}$$

EXAMPLE

Prime cost method (ignoring any GST impact)

Using the facts of the previous example, if Laura chooses to work out the decline in value of the photocopier using the prime cost method, the decline in value for the 2001–02 income year was $300. This is worked out as follows:

$$1500 \times \frac{365}{365} \times \frac{100\%}{5}$$

If Laura uses the photocopier wholly for taxable purposes in that income year, she is entitled to a deduction equal to the decline in value. The adjustable value of the asset at 30 June 2002 would be $1200. This is the cost of the asset ($1500) less its decline in value up to that time ($300).

An **adjusted prime cost formula** must be used if:

- you recalculate the effective life of an asset—see **Effective life** on page 10
- an amount is included in the second element of cost of an asset's cost after the income year in which the asset's start time occurs
- an asset's cost or adjustable value is reduced by a debt forgiveness amount—see **Commercial debt forgiveness** on page 14

- there is roll-over relief and the transferor was using the prime cost method—see **Roll-over relief** on page 27
- you must reduce the opening adjustable value of a depreciating asset which is the replacement asset for an asset subject to an involuntary disposal—see **Involuntary disposal of a depreciating asset** on page 17, or
- an asset's opening adjustable value is modified due to GST increasing or decreasing adjustments or to input tax credits for amounts included in the second element of cost an asset—see **GST input tax credits** on page 12.

The adjusted prime cost formula must be used from an income year in which any of these changes are made (a 'change year'). The formula is:

$$\text{Opening adjustable value for the change year plus any second element of cost for that year} \times \frac{\text{days held}}{365} \times \frac{100\%}{\text{asset's remaining effective life}}$$

The asset's **remaining effective life** is any period of its effective life that is yet to elapse at the start of the change year.

The prime cost formula must also be adjusted for certain intangible depreciating assets you acquire from a former holder—see **Effective life of intangible depreciating assets** on page 11.

Depreciating assets held before 1 July 2001

To work out the decline in value of depreciating assets you held before 1 July 2001, you generally use the same cost, effective life and method that you were using under the former law.

The undeducted cost of the asset at 30 June 2001 becomes its opening adjustable value at 1 July 2001. The undeducted cost of the asset is worked out under the former depreciation rules. It is the asset's cost less the depreciation for the asset up to 30 June 2001, assuming that it was used wholly for producing assessable income.

EXAMPLE

Working out the decline in value of a depreciating asset held before 1 July 2001 (ignoring any GST impact)

Audrey purchased a computer on 1 July 2000 for $3200 and started using it from that date for producing assessable income. The effective life of the computer is 4 years. Audrey used the computer 25 per cent for private purposes during the 2000–01 income year.

Using the prime cost method, Audrey's depreciation deduction in the 2000–01 income year was $600. The undeducted cost of the computer at 30 June 2001 was $2400. This is the computer's cost of $3200 less its depreciation up to that time, assuming it was used wholly for producing assessable income ($800). The undeducted cost of the computer at 30 June 2001 becomes its opening adjustable value at 1 July 2001.

To work out the decline in value of the computer in the 2001–02 income year, Audrey uses the same cost, effective life and method that she used under the former rules. On that basis, the decline in value of the asset is $800:

$$3200 \times \frac{365}{365} \times \frac{100\%}{4}$$

If Audrey used the computer only 75 per cent for taxable purposes in that income year, her deduction is reduced to $600, being 75 per cent of $800.

The adjustable value of the computer at 30 June 2002 would be $1600—the opening adjustable value ($2400) less the decline in value for the income year ($800).

For a depreciating asset that is an item of intellectual property or a spectrum licence and for certain depreciating assets used in mining, quarrying or minerals transport, the opening adjustable value at 1 July 2001 is the amount of unrecouped expenditure for the asset at 30 June 2001 as these assets do not have an undeducted cost under the former rules.

Special transitional rules apply to plant for which you used accelerated rates of depreciation before 1 July 2001 or could have had you used the plant for producing assessable income. These rules ensure that accelerated rates continue to apply under the UCA—see **Accelerated depreciation** below.

If you have a substituted accounting period for your income year that includes 1 July 2001, you need to work out your deduction in 2 parts. First, you need to calculate your deductions under the former rules from the beginning of the substituted accounting period to 30 June 2001. You then need to work out the decline in value of the depreciating assets from 1 July 2001 to the end of the substituted accounting period under the new rules. If you use the diminishing value method, your deduction may be less than it would have been had you done only one calculation for the income year under the former rules. In that case, you can increase your deduction by the difference between the 2 amounts.

Accelerated depreciation

For plant acquired between 27 February 1992 and 11.45 a.m. (by legal time in the ACT) on 21 September 1999, accelerated rates of depreciation and broadbanding were available. The rates were based on effective life adjusted by a loading of 20 per cent and broadbanded into one of 7 rate groups. The loading together with the broadbanding produced accelerated rates of deductions for depreciation.

Except for certain small business taxpayers, accelerated rates of depreciation are not available for plant you:

- acquired under a contract entered into after 11.45 a.m. (by legal time in the ACT) on 21 September 1999
- constructed, with construction starting after that time or
- acquired in some other way after that time.

Small business taxpayers could continue to use accelerated rates for plant acquired after that time if they met certain conditions when the plant was first used or installed ready for use. However, accelerated rates of depreciation have now been removed for small business taxpayers for depreciating assets they:

- start to hold under a contract entered into after 30 June 2001
- construct and construction begins after 30 June 2001 or
- start to hold in some other way after 30 June 2001.

If you used accelerated rates of depreciation for an item of plant before 1 July 2001 or could have had you used the plant for producing assessable income, you continue to use accelerated rates to work out the decline in value under the UCA. You replace the effective life component in the formula for working out the decline in value with the rate you are using.

For a list of accelerated rates of depreciation, see **Accelerated rates of depreciation** on page 29.

EXAMPLE

Working out decline in value using accelerated rates of depreciation (ignoring any GST impact)

Peter purchased a machine for $100 000 on 1 July 1999. As the machine was acquired before 21 September 1999, Peter can use accelerated rates of depreciation to calculate his deductions. Using the prime cost method, a depreciation rate of 20 per cent applies as the machine has an effective life of 8 years. The machine is used wholly in Peter's business. His depreciation deduction in each of the 1999–2000 and 2000–01 income years was $20 000, being 20 per cent of $100 000. This means the undeducted cost of the machine on 30 June 2001 and its opening adjustable value on 1 July 2001 was $60 000.

To work out his deductions for the 2001–02 income year, Peter continued to use the same cost, method and rate that he was using before the start of the UCA. The decline in value of the machine for the 2001–02 income year of $20 000 was worked out as follows:

$$\text{Asset's cost} \times \frac{\text{days held}}{365} \times \text{prime cost rate}$$

$$100\,000 \times \frac{365}{365} \times 20\%$$

Decline in value of depreciating asset used for non-taxable purpose

The decline in value and adjustable value of a depreciating asset are calculated from the start time independently of your use of the depreciating asset for a taxable purpose. However, your deduction for the decline in value is reduced to the extent your use of the asset is not for a taxable purpose.

EXAMPLE

Deduction for the decline in value of a depreciating asset used partly for non-taxable purposes (ignoring any GST impact)

Leo purchases a computer for $6000 and uses it only 50 per cent of the time for taxable purposes during the income year. If the computer's decline in value for the income year is $1000, Leo's deduction would be reduced to $500, being 50 per cent of the computer's decline in value for the income year. The adjustable value at the end of the income year would be $5000, irrespective of the extent of Leo's use of the asset for taxable purposes.

Decline in value of leisure facilities and boats

Your deduction for the decline in value of a depreciating asset may be reduced if the asset is a leisure facility or a boat even though it is used, or installed ready for use, for a taxable purpose. The deduction is reduced to the extent the asset is not integral to your income-producing activities or to the extent its use does not constitute a fringe benefit.

Depreciating asset acquired from an associate

If you acquire plant on or after 9 May 2001 or another depreciating asset on or after 1 July 2001 from an associate, such as a relative or partner, and the associate claimed or can claim deductions for the decline in value of the asset, you must use the same method of working out the decline in value as the associate used.

You must also use the same effective life as the associate used where they used the diminishing value method or an effective life equal to the remaining period of the effective life used by them where they used the prime cost method.

You must recalculate the effective life of the depreciating asset if the asset's cost increases by 10 per cent or more in any income year, including the one in which you start to hold it—see **How to recalculate effective life** on page 12 for information about recalculating the effective life of a depreciating asset.

You can require the associate to tell you what method and effective life they used by serving a notice on them within 60 days after you acquire the asset. Penalties can be imposed if the associate intentionally refuses or fails to comply with the notice.

Holder changes but user same or associate of former user

If you become the holder of plant on or after 9 May 2001 or another depreciating asset after 1 July 2001 but the user of the asset does not change or is an associate of the former user—for example, under a **sale and leaseback arrangement**—you must use the same method of working out the decline in value that the former holder used.

You must also use the effective life the former holder used where they used the diminishing value method or the effective life equal to the remaining period of the effective life used by them where they used the prime cost method.

If you cannot readily ascertain the method the former holder used or if they did not use a method, you must use the diminishing value method. An effective life determined by the Commissioner of Taxation must be used if you cannot find out the effective life the former holder used or if they did not use an effective life.

You must recalculate the effective life of the depreciating asset if the asset's cost increases by 10 per cent or more in any income year, including the one in which you start to hold it—see **How to recalculate effective life** on page 12 for information about recalculating effective life.

Immediate deduction for certain depreciating assets costing $300 or less

The immediate deduction for plant costing $300 or less was removed from 1 July 2000 except for some plant used predominantly to produce non-business income and for small business taxpayers who could continue to claim the deduction until the start of the STS on 1 July 2001.

Under the UCA rules, the decline in value of certain depreciating assets costing $300 or less (after GST credits or adjustments) is their cost. This means you get an immediate deduction for the cost of the asset to the extent that you use it for a taxable purpose during the income year in which the deduction is available.

The immediate deduction is available when you start to hold a depreciating asset in an income year and the asset costs $300 or less and:

- is used predominantly for the purpose of producing assessable income that is not derived from carrying on a business
- is not part of a set of assets you start to hold in that year that costs more than $300
- is not one of a number of identical or substantially identical assets acquired in the same year that together cost more than $300.

EXAMPLE

Depreciating asset used in carrying on a business

Rob buys a spanner for $50. The spanner is used 100 per cent in Rob's mechanics business. As the spanner is used for producing assessable income from carrying on a business, Rob cannot claim an immediate deduction for it under the UCA rules. He must work out the decline in value using the general rules for working out decline in value or allocate the asset to a low-value pool.

EXAMPLE

Set of items

Paula, a primary school teacher, is buying a series of story books costing $65 each. The books are labelled volumes 1 to 10 but she buys one volume every month during the school year. Although Paula only received 5 volumes before 30 June 2002, she cannot claim an immediate deduction for any of these books because they form part of a set with a total cost of more than $300.

EXAMPLE

Substantially identical items

Jan buys 3 kitchen stools for her rental property. The stools, which are substantially identical, cost $150 each. Jan cannot claim an immediate deduction for the cost of each individual stool because they are substantially identical and their total cost exceeds $300.

Examples of depreciating assets which could be eligible for the immediate deduction are:

- tools of trade acquired by an apprentice for their trade
- a briefcase purchased by a salary and wage earner for their job
- furniture purchased by a landlord for their rental property.

The immediate deduction is not available for expenditure or depreciating assets deductible under the rules for:

- primary production depreciating assets—see **Primary production depreciating assets** on page 21
- certain capital expenditure of primary producers and other landholders—see **Capital expenditure of primary producers and other landholders** on page 22
- in-house software if you have allocated expenditure on it to a software development pool—see **Software development pools** on page 20.

Effective life

In broad terms, the **effective life** of a depreciating asset is how long it can be used by any entity for a taxable purpose or for the purpose of producing exempt income, having regard to the wear and tear you reasonably expect from your expected circumstances of use and assuming reasonable levels of maintenance. Effective life is expressed in years, including fractions of years. It is not rounded to the nearest whole year.

Choice of determining effective life

For most depreciating assets, you have a choice to either work out the effective life yourself or use an effective life determined by the Commissioner.

The choice must be made for the income year in which the asset's start time occurs. Generally, the choice must be made by the time you lodge your income tax return for that year.

However, the choice is not available for:

- most intangible depreciating assets—see **Effective life of intangible depreciating assets** on page 11
- a depreciating asset acquired from an associate who claimed or could have claimed deductions for the asset's decline in value—see **Depreciating asset acquired from an associate** on page 8
- a depreciating asset which you start to hold if the user of the asset does not change or is an associate of the former user—for example, under a sale and leaseback arrangement—see **Holder changes but user same or associate of former user** on page 9.

Working out the effective life yourself

If you decide to work out the effective life yourself, you need to take into account:

- how long you expect the asset can be used for a taxable purpose or for the purpose of producing exempt income, irrespective of who uses it
- the wear and tear you reasonably expect from your expected circumstances or use
- that it will be maintained in reasonably good order and condition
- how you expect to use the asset
- whether it would be likely for the asset to be scrapped or abandoned before the end of its useful life.

The sort of information which you could use to make an estimate of effective life of an asset includes:

- manufacturer's specifications
- independent engineering information
- your own past experience with similar assets
- the past experience of other users of similar assets
- the level of repairs and maintenance commonly adopted by users of the asset
- retention periods
- scrapping or abandonment practices
- the physical life of the asset.

You work out the effective life of a depreciating asset from the asset's start time.

Commissioner's determination

In making his determination, the Commissioner assumes the depreciating asset is new and has regard only to general industry circumstances of use.

The table attached to *Taxation Ruling IT 2685—Income tax: depreciation* lists the effective life of various items of plant as determined by the Commissioner. IT 2685 was issued on 11 June 1992 and remained in force until it was replaced by *Taxation Ruling TR 2000/18—Income tax: depreciation effective life*. TR 2000/18 came into force on 1 January 2001 and lists the Commissioner's determination of effective life for various depreciating assets. To find out how to get these rulings, see the inside front cover.

As a general rule, the schedule of effective lives accompanying IT 2685 should be used for depreciating assets acquired or started to be constructed before 1 January 2001. The schedule accompanying TR 2000/18 should be used for depreciating assets acquired or constructed on or after 1 January 2001.

Because the Commissioner often reviews his determinations of effective life, more than one determination might be in force during an income year. You generally adopt the determination that is in force at the time you enter into a contract to acquire an asset, you otherwise acquire it, or you start to construct it. However, if the asset's start time does not occur within 5 years of this time, you must use the determination that is in force at the asset's start time. For a depreciating asset acquired under a contract or otherwise, or started to be constructed before 11.45 a.m. (by legal time in the ACT) on 21 September 1999, there is no restriction on the period within which the asset must be first used.

NOTE IT 2685 contains depreciation rates—accelerated rates and broadbanded rates—which should only be used for plant that was acquired before 21 September 1999 or by certain small business taxpayers before 1 July 2001—see **Accelerated depreciation** on page 7.

For an extract from the rulings showing the effective lives of some commonly used items, see **Extracts from Taxation Ruling IT 2685 and Taxation Ruling TR 2000/18—effective lives** on page 29.

Effective life of intangible depreciating assets

The effective life of most intangible depreciating assets is prescribed under the UCA.

Asset	Effective life in years
1 Standard patent	20
2 Innovation patent	8
3 Petty patent	6
4 Registered design	15
5 Copyright	The shorter of 25 years from when you acquire it or the period until the copyright ends
6 A licence (except a copyright or in-house software)	The term of the licence
7 A licence relating to a copyright	The shorter of 25 years from when you become the licensee or the period until the licence ends
8 In-house software	2½
9 Spectrum licence	The term of the licence
10 Datacasting transmitter licence	15

The effective life of an intangible depreciating asset listed in the table above cannot be self-assessed or recalculated.

The effective life of an indefeasible right to use an international telecommunications submarine cable system is the effective life of the international telecommunications submarine cable over which the right is granted.

The effective life of any other intangible depreciating asset is limited to the term of the asset as extended by any reasonably assured extension or renewal of that term.

If you acquire any of the intangible assets listed in the table above from a former holder (except items 5, 7 or 8) and you choose to calculate the asset's decline in value under the prime cost method, you must adjust the prime cost formula. Instead of using the effective life shown in the table above in the formula, you must use the number of years remaining in that effective life as at the start of the year you acquired the asset. For information on the prime cost method, the prime cost formula and the adjusted prime cost formula, see **Methods of working out decline in value** on page 5.

Choice of recalculating effective life

You may choose to recalculate the effective life of a depreciating asset if the effective life you have been using is no longer accurate because the circumstances of the nature of your use have changed. You can recalculate an asset's effective life each time your circumstances change. It can be done in any income year after the one in which the asset's start time occurs and whether you worked out the previous effective life yourself or you used the effective life determined by the Commissioner.

Some examples of changed circumstances relating to the nature of your use of the asset are:

- your use of the asset turns out to be more or less rigorous than expected
- there is a downturn in the demand for the goods or services that the asset is being used to produce that will result in the plant being scrapped
- legislation prevents the asset's continued use
- changes in technology make the asset redundant.

You cannot choose to recalculate the effective life of any depreciating asset for which you:

- used accelerated rates of depreciation before 1 July 2001—see **Accelerated depreciation** on page 7 for information on accelerated rates of depreciation, or
- could have used accelerated rates of depreciation before 1 July 2001 if you had used the asset to produce assessable income or had it installed ready for that use.

In addition, the effective life of certain intangible depreciating assets cannot be recalculated—see **Effective life of intangible depreciating assets** in the previous column.

Requirement to recalculate effective life

In some circumstances, you must recalculate the effective life of a depreciating asset.

You must recalculate the effective life if its cost is increased by 10 per cent or more in an income year after the one in which its start time occurs and you either:

- worked out the effective life of the asset yourself or
- used the Commissioner's determination of effective life and the prime cost method to work out the asset's decline in value.

Even though you may be required to recalculate the effective life of an asset, you may conclude that the effective life is the same.

You may also be required to recalculate the effective life of a depreciating asset you:

- acquired from an associate who claimed or could have claimed deductions for the asset's decline in value—see **Depreciating asset acquired from an associate** on page 8, or
- become the holder of where the user of the asset does not change or is an associate of the former user—for example, under a sale and leaseback arrangement—see **Holder changes but user same or associate of former user** on page 9.

How to recalculate effective life

The recalculated effective life is worked out from the depreciating asset's start time. You use the same principles to recalculate the effective life of a depreciating asset as you would to work out the original effective life—see **Working out the effective life yourself** on page 10.

Effect of recalculating effective life

If you recalculate the effective life of a depreciating asset, the new effective life starts to apply for the income year for which you make the recalculation.

If you are using the diminishing value method to work out the decline in value of a depreciating asset, the new estimate of effective life is used in the formula as the asset's effective life. Under the prime cost method, the adjusted prime cost formula must be used from the year in which you recalculate the asset's effective life—see **Methods of working out decline in value** on page 5 for information about the adjusted prime cost formula.

The cost of a depreciating asset

To work out the decline in value of a depreciating asset, you need to know its cost.

Under the UCA, the cost of a depreciating asset has 2 elements.

The **first element** of cost is, broadly, amounts you are taken to have paid to hold the asset, such as the purchase price, and any additional amounts you spend on transporting it or installing it in position. It is worked out at the time you begin to hold the asset. The **second element** of cost is capital expenditure incurred after that time, such as a cost of improving the asset.

EXAMPLE

First and second elements of cost (ignoring any GST impact)

Terry purchases a car for $45 000. The first element of cost is $45 000. If Terry installs a car alarm in the vehicle 2 months later at a cost of $1500, that amount will be included in the second element of cost of the car as it was incurred after he began to hold the car.

The cost of a depreciating asset includes not only amounts you pay but also the market value of any non-cash benefits you provide in relation to the asset. It would also include a liability you incur to pay an amount or to provide a non-cash benefit.

Cost is impacted by:

- amounts of input tax credits for which you are or become entitled—see **GST input tax credits** below
- expenditure not of a capital nature or
- any amount that you can deduct or which is taken into account in working out a deductible amount under provisions outside the UCA.

EXAMPLE

Expenditure not of a capital nature and deductible outside the UCA

Carolyn uses a motor vehicle for her business. As a result of Carolyn's use of the vehicle, she needs to replace the tyres. The cost of replacing the tyres is not included in the second element of the vehicle's cost because it would ordinarily be deductible under the repair provisions.

There are special rules to work out the cost of depreciating assets in certain circumstances. Some of the common cases are covered below. If you are not sure of the cost of a depreciating asset, contact your professional tax adviser or the ATO.

Recoupment of cost

Recoupment of any amount included in the cost of a depreciating asset is included in assessable income.

GST input tax credits

If the acquisition or importation of a depreciating asset constitutes a creditable acquisition or a creditable importation, the cost or opening adjustable value of the asset is reduced by any input tax credit you are, or become, entitled to in relation to its acquisition or importation. For an explanation of opening adjustable value—see **Methods of working out decline in value** on page 5.

If the cost of a depreciating asset is taken to be its market value (such as for assets acquired under a private or domestic arrangement), the market value is reduced by any input tax credit to which you would be entitled had the acquisition been solely for a creditable purpose.

Similarly, any input tax credit you are entitled to claim in relation to the second element of a depreciating asset's cost reduces the cost or opening adjustable value of the asset.

Certain adjustments under the GST legislation reduce or increase the cost or opening adjustable value of the asset. Other adjustments are treated as an outright deduction or income.

Car limit for certain motor vehicles

Cars designed mainly for carrying passengers are subject to a car limit. If the first element of cost exceeds the car limit for the income year in which you start to hold it (after any adjustments required for acquisition discounts—see **Car acquired at a discount** below—and for any input tax credit or adjustment—see **GST input tax credits** on page 12), that first element of cost is reduced to the car limit. The car limit also applies under the luxury car lease rules—see **Leased luxury cars** on page 3. It does not apply in certain circumstances to some cars fitted out for transporting disabled people.

The car limit is $55 134 for this income year.

When in time a balancing adjustment event occurs for the car, the termination value must be adjusted under a special formula—see **Balancing adjustment rules for cars** on page 16.

Car acquired at a discount

If a car is acquired at a discount, the first element of its cost may be increased by the amount of the discount.

This will happen to the extent that any portion of the discount (the discount portion) is referable to the disposal for less than market value of another asset (for example, a trade-in) for which any entity has deducted or can deduct an amount at any time.

This rule does not apply to some cars fitted out for transporting disabled people.

The adjustment is only made if the cost of the car (after GST credits or adjustments) plus the discount portion exceeds the car limit. A car's cost is not otherwise affected by an acquisition discount for other reasons.

When in time a balancing adjustment event occurs for the car, the termination value must be increased by the same discount portion—see **Balancing adjustment rules for cars** on page 16.

EXAMPLE

Car acquired at a discount (ignoring any GST impact)

Kristine arranges to buy a $60 000 sedan for business use from Greg, a car dealer. She offers the station wagon she is using for this purpose, worth $20 000, as a trade-in. Greg agrees to reduce the price of the sedan to below the car limit if Kristine accepts less than market value for the trade-in. Kristine agrees to accept $15 000 for the trade-in and the price of the sedan is reduced to $55 000.

The pre-discount price of the sedan is more than the car limit so the first element of the car's cost is increased by the amount of the discount to $60 000. As the first element of cost then exceeds the car limit, it must be reduced to the car limit for the income year.

The termination value of the wagon would be taken to be the market value of $20 000.

Non-arm's length and private or domestic arrangements

If you acquire a depreciating asset for more than its market value and do not deal at arm's length with another party to the transaction or if you acquire a depreciating asset under a private or domestic arrangement (for example, as a gift from a family member), the first element of cost is the market value of the asset at the time you start to hold it—see **GST input tax credits** on page 12 for information on market value.

These rules also apply to the second element of a depreciating asset's cost. For example, if something is done to improve your depreciating asset under a private or domestic arrangement, the second element of the asset's cost is the market value of the improvement when it is made.

Note that there are special rules for working out the effective life and decline in value of a depreciating asset acquired from an associate, such as a spouse or partner—see **Depreciating asset acquired from an associate** on page 8.

Depreciating asset acquired with other property

If you pay an amount for a depreciating asset and something else, only that part of the payment that is reasonably attributable to the depreciating asset is treated as being paid in relation to it. This applies to first and second elements of cost.

The ATO generally accepts independent valuations as a basis for this apportionment. However, if there is no independent valuation, you may need to demonstrate that your apportionment of the amount paid is reasonable. Apportionment on the basis of the market values of the various items for which the payment is made will generally be reasonable.

EXAMPLE

Apportionment of cost

Sam undertakes to pay an upholsterer $800 for a new desk and $300 to re-upholster a chair. He negotiates a trade discount of $100. The $1000 paid could be apportioned between:

- **the first element of cost of the desk**
- **the second element of cost of the chair**

based on the relative market values of the desk and the labour and materials used to upholster the chair.

Hire purchase agreements

For income tax purposes, hire purchase transactions entered into after 27 February 1998 are treated as a sale of goods by the financier (or hire purchase company) to the hirer, financed by a loan from the financier to the hirer.

If the subject property is a depreciating asset, the hirer is treated as the holder of the depreciating asset and is entitled to deductions for the decline in value. The cost of the depreciating asset for this purpose is taken to be the cost or value stated in the hire purchase agreement or, if the dealing was not at arm's length, the amount that could have been expected to have been paid to buy the goods under an arm's length dealing—see **Depreciating assets subject to hire purchase agreements** on page 3.

Death of the holder

If a depreciating asset starts being held by you as a legal personal representative (say, as the executor of an estate) as a result of the death of the former holder, the cost of the asset is its adjustable value at the time the former holder died—see **Methods of working out decline in value** on page 5 for an explanation of adjustable value.

If you start to hold the depreciating asset because it passes to you as a beneficiary of the estate or as a surviving joint tenant, the cost of the asset is the market value when you started to hold it reduced by any capital gain that was ignored when the owner died or when it passed from the legal personal representative. See the *Guide to capital gains tax* for information about when these gains can be disregarded. To find out how to get this publication, see the inside front cover.

Commercial debt forgiveness

Generally, an amount which you owe is a commercial debt if you can claim a deduction for the interest paid on the debt or you would have been able to claim a deduction for interest if it had been charged. The amount of the commercial debt includes any unpaid interest.

If a commercial debt is forgiven, you may be required to reduce expenditure deductible under the UCA by all or part of the net forgiven amount. If the reduction of deductible expenditure is to be made in relation to depreciating assets whose decline in value is calculated under the diminishing value method, it reduces the base value from which the decline in value is calculated or, if under the prime cost method, it reduces the cost from which the decline in value is calculated. If the prime cost method is used for the income year in which the change is made and in later years, you need to use the adjusted prime cost formula—see **Methods of working out decline in value** on page 5.

What happens if you no longer hold or use a depreciating asset?

Under the UCA rules, if you cease to hold or to use a depreciating asset, a balancing adjustment event may occur. If there is a balancing adjustment event, you need to calculate a balancing adjustment amount to include in your assessable income or to claim as a deduction.

A **balancing adjustment event** occurs for a depreciating asset when:

- you stop holding it—for example, if the asset is sold, lost or destroyed
- you stop using it and expect never to use it again
- you stop having it installed ready for use and you expect never to install it ready for use again
- you have not used it and decide never to use it or
- a change occurs in the holding or interests in an asset which was or is to become a partnership asset.

A balancing adjustment event does not occur just because a depreciating asset is split or merged—see **Split or merged depreciating assets** on page 18. However, a balancing adjustment event does occur if you stop holding part of an asset.

The **balancing adjustment amount** is worked out by comparing the asset's **termination value** and its adjustable value at the time of the balancing adjustment event. If the termination value is greater than the adjustable value, the excess is included in your assessable income. If the termination value is less than the adjustable value, you can deduct the difference.

EXAMPLE

Working out an assessable balancing adjustment amount (ignoring any GST impact)

Bridget purchased a cabinet for $2000 on 1 July 2000. She used the cabinet from that date wholly for a taxable purpose. The cabinet was sold on 30 June 2002 for $1300. Its adjustable value at that time was $1200.

As the termination value of $1300 is greater than the adjustable value of the cabinet at the time of its sale, the difference of $100 is included in Bridget's assessable income.

EXAMPLE

Working out a deductible balancing adjustment amount (ignoring any GST impact)

If Bridget sells the cabinet for $1000, the termination value is less than the adjustable value of the cabinet at the time of its sale ($1200). Bridget can deduct the balancing adjustment amount of $200.

There are situations where these general balancing adjustment rules do not apply:

- If a depreciating asset has been used for a non-taxable purpose, the balancing adjustment amount is reduced to reflect that non-taxable use. Additionally, a capital gain or capital loss can arise to the extent of the non-taxable use—see **Depreciating asset used for non-taxable purpose** in the next column.
- Similarly, if the depreciating asset is a leisure facility or a boat and your deductions for the decline in value of the asset have been reduced, the balancing adjustment amount is reduced and a capital gain or capital loss can arise—see **Leisure facilities and boats** on page 16.
- There are special balancing adjustment rules for cars—see **Balancing adjustment rules for cars** on page 16.
- A balancing adjustment event for a depreciating asset in a low-value or common-rate pool or for which expenditure has been allocated to a software development pool is dealt with under specific rules for those pools—see **Balancing adjustment event for a depreciating asset in a low-value pool** on page 20, **Common-rate pools** on page 21 and **Software development pools** on page 20.
- If the disposal of a depreciating asset is involuntary, you can offset an assessable balancing adjustment amount—see **Involuntary disposal of a depreciating asset** on page 17.
- Roll-over relief may apply to the disposal of a depreciating asset in certain circumstances, such as where an asset is transferred between spouses pursuant to a court order following a marriage breakdown—see **Roll-over relief** on page 27.
- There are special balancing adjustment rules for depreciating assets used in carrying on research and development activities—see the *Research and development tax concession schedule and instructions* for more information.

Termination value

The termination value is, generally, what you receive for the asset when a balancing adjustment event occurs. It is made up of amounts received and the market value of non-cash benefits (such as goods or services) you have received for the asset.

The most common example of termination value is the proceeds from selling an asset. The termination value may also be an insurance pay-out for the loss or destruction of a depreciating asset.

Apart from what is actually received, termination value can be what is taken to have been received under the legislation. For example, if you dispose of a depreciating asset for less than market value and do not deal at arm's length with the other parties to the transaction, or you stop holding an asset under a private or domestic arrangement (for instance, you give an asset to a family member), the termination value of the asset is its market value just before you stopped holding it.

The termination value of a unit of in-house software you still hold but stop using and expect never to use again or decide never to use is zero—see **Units of in-house software** on page 20.

The termination value is different for any other asset. If you stop using the asset and expect never to use it again but still hold it, the termination value is the market value when you stop using it. For a depreciating asset you decide never to use but still hold, the termination value is the market value when you make the decision.

If you die and a depreciating asset starts to be held by your legal personal representative (the executor or administrator of your estate), a balancing adjustment event occurs. The termination value of the asset is its adjustable value at the date of death. If the asset passes directly to a beneficiary of the estate or to a surviving joint tenant, the termination value is the market value just before you die.

The termination value is reduced by the GST payable if the balancing adjustment event is a taxable supply. It can be modified by increasing or decreasing adjustments. If the termination value is taken to be the market value of the asset, the market value is reduced to exclude the GST payable if the balancing adjustment event is a taxable supply.

If you receive a payment for several items that include a depreciating asset, you need to apportion the payment between the termination value of the depreciating asset and the other items.

In most cases, the termination value can be reduced by any expenses of the balancing adjustment event—for example, advertising or commission expenses. The expenses must not be otherwise deductible.

Depreciating asset used for non-taxable purpose

If a depreciating asset is used for both taxable and non-taxable purposes, the balancing adjustment amount must be reduced by the amount that is attributable to the non-taxable use. In addition, a capital gain or capital loss may arise under the capital gain and capital loss provisions in respect of the difference between the asset's cost and its termination value that is attributable to the non-taxable use.

For depreciating assets that are used wholly for non-taxable purposes, the balancing adjustment amount is reduced to zero. The difference between the asset's termination value and its cost can be a capital gain or capital loss.

For some depreciating assets, any capital gain or capital loss arising will be disregarded even though the asset is used for non-taxable purposes. These assets include:

- assets acquired before 20 September 1985
- cars that are designed to carry a load of less than one tonne and less than 9 passengers
- motor cycles
- valour or brave conduct decorations awarded
- a collectable (such as a painting or an antique) if the first element of its cost is $500 or less
- assets for which you can deduct an amount for the decline in value under the STS rules for the income year in which the balancing adjustment event occurred
- assets used to produce exempt income.

In addition, a capital gain arising from the disposal of a personal use asset (an asset used or kept mainly for personal use or enjoyment) of which the first element of cost is $10 000 or less and a capital loss arising from the disposal of any personal use asset are disregarded for capital gains tax purposes.

EXAMPLE

Sale of a depreciating asset used partly for a taxable purpose (ignoring any GST impact)

Andrew sells a computer for $600. The computer's cost is $1000. It has been used 40 per cent for private purposes. At the time of its sale, the computer's adjustable value is $700.

Andrew can claim a deduction for the balancing adjustment amount of $60. This is 60 per cent (the proportion of use for a taxable purpose) of the balancing adjustment amount (the difference between the computer's termination value and its adjustable value at the time of its sale).

In addition, a capital loss of $160 arises. This is 40 per cent (the proportion of use for a non-taxable purpose) of the difference between the computer's termination value and its cost.

Leisure facilities and boats

If a balancing adjustment event occurs to a depreciating asset that is a leisure facility or a boat and your deductions for the decline in value of the asset have been reduced—see **Decline in value of leisure facilities and boats** on page 8—the balancing adjustment amount is reduced to the extent the deductions for decline in value were reduced. In addition, a capital gain or capital loss may arise in respect of the difference between the asset's cost and its termination value that is attributable to the reduction. These rules are similar to those for working out the balancing adjustment amount for a depreciating asset used for a non-taxable purpose.

Plant acquired before 11.45 a.m. on 21 September 1999 and other depreciating assets acquired before 1 July 2001

If a balancing adjustment event occurs to an item of plant that was acquired before 11.45 a.m. (by legal time in the ACT) on 21 September 1999 or any other depreciating asset acquired before 1 July 2001, any assessable balancing adjustment amount or capital gain (if the plant was used for non-taxable purposes) can be reduced to take account of the amount by which the capital gains tax cost base of the asset exceeds its cost. One reason that the cost base might exceed the cost is **indexation** of the cost base.

The purpose of this reduction is to preserve cost base advantages for assets acquired before the dates mentioned (for example, indexation benefits).

The reduction is worked out having regard to the capital gains tax concepts of cost base and indexation.

See the *Guide to capital gains tax* for more information about indexation of a cost base and the impact of indexation on discount capital gains. To find out how to get this publication, see the inside front cover.

Balancing adjustment rules for cars

If a balancing adjustment event occurs for your car, you need to work out any balancing adjustment amount. Special rules apply to the calculation of balancing adjustment amounts for cars.

If a balancing adjustment event occurs for a car used for non-taxable purposes (even if it is used or kept mainly for personal use and enjoyment), any capital gain or capital loss is disregarded.

If you use the 'one-third of actual expenses' or the 'log book' method of claiming car expenses, your balancing adjustment amount needs to be reduced by the amount that is attributable to the use of the car for non-taxable purposes.

EXAMPLE

If you use the 'one-third of actual expenses' method (ignoring any GST impact)

Louise acquired a car on 1 July 1999 for $26 000. During both the 2000–01 and 2001–02 income years, Louise used the 'one-third of actual expenses' method to work out her deductions for car expenses. She sold her car for $24 500 on 30 June 2002. At that time, the adjustable value of the car was $18 200.

Louise's balancing adjustment amount is reduced by the amount attributable to her use of the car for a non-taxable purpose. As she uses the 'one-third of actual expenses' method, her balancing adjustment amount is reduced by $^2/_3$. Louise's balancing adjustment is $2100; that is, one-third of the difference between the termination value and the adjustable value of the car. Louise must include the amount of $2100 in her assessable income.

EXAMPLE

If you use the 'log book' method (ignoring any GST impact)

If Louise uses the 'log book' method to work out her deductions for car expenses and her log book shows that the level of her business use is 40 per cent, her balancing adjustment amount is $2520. This is 40 per cent of the difference between the termination value and the adjustable value of the car. Louise must include the amount of $2520 in her assessable income.

If you have used the 'cents per kilometre' method or the '12 per cent of original value' method of claiming car expenses, no balancing adjustment amount arises because the decline in value of the car is not worked out separately under those methods: rather, it is taken into account as part of the calculation of the car expenses. However, if you switch between these methods and the 'one-third of actual expenses' or 'log book' methods of claiming car expenses, you may have to work out a balancing adjustment amount. This is only expected to occur in a limited number of cases. If you are affected and you are unsure of how to work out your balancing adjustment amount, contact your professional adviser or the ATO.

For a car subject to the car limit described at **Car limit for certain motor vehicles** on page 13, the termination value is reduced to an amount determined by the following formula:

$$\frac{\text{Car limit} + \text{amounts included in the second element of cost of the car}}{\text{total cost of the car (ignoring the car limit)}}$$

If a car was acquired at a discount and the cost of the car was increased by a discount portion—see **Car acquired at a discount** on page 13—the termination value of that car must also be increased by that discount portion. This will impact on the balancing adjustment amount.

If a lessee under a luxury car lease or a hirer under a hire purchase agreement does not actually acquire the car, they are treated as disposing of the asset to the lessor or financier, respectively. This constitutes a balancing adjustment event and any balancing adjustment amount needs to be worked out.

Involuntary disposal of a depreciating asset

An involuntary disposal occurs if a depreciating asset is:

- lost or destroyed
- compulsorily acquired by an Australian government agency or
- disposed of to an Australian government agency after compulsory negotiations

after 11.45 a.m. (by legal time in the ACT) on 21 September 1999.

You may offset an assessable balancing adjustment amount arising from an involuntary disposal against the cost or the opening adjustable value plus second element costs of one or more replacement assets. You must incur the expenditure on the replacement asset, or start to hold it, no earlier than one year before the involuntary disposal and no later than one year after the end of the income year in which the disposal occurred. The Commissioner can agree to extend the time limit.

To offset the assessable balancing adjustment amount, the replacement asset must be wholly used for a taxable purpose and you must be able to deduct an amount for it.

Roll-over relief

If roll-over relief is available under the UCA rules, no balancing adjustment amount arises on the balancing adjustment event that happens when a change occurs in the holding of or in the interests in a depreciating asset.

In some cases, roll-over relief is automatic—transfers pursuant to a court order following a marriage breakdown and transfers to a wholly-owned company or to another member of a wholly-owned group.

In some cases, roll-over relief must be chosen—if the event arises from a variation in the constitution of a partnership or in a partnership interest. The transferor and the transferee must jointly choose the roll-over relief.

When roll-over relief applies, the transferee of the depreciating asset can claim deductions for the asset's decline in value as if there had been no change in holding.

If the transferor used the prime cost method to work out decline in value, the transferee should use the same method and must use the adjusted prime cost formula—see **Methods of working out decline in value** on page 5.

There are specific record keeping requirements for roll-over relief—see **Roll-over relief** on page 27.

Limited recourse debt arrangements

If a depreciating asset is acquired under a limited recourse debt arrangement (including a hire purchase agreement or instalment sale) which terminates after 27 February 1998 and part of the debt principal remains unpaid because of the limited recourse, an adjustment to assessable income may be required. To the extent that the capital allowance deductions exceed the actual amount outlaid under the arrangement, an amount is included in assessable income.

If you are not sure how to work out your adjustment to assessable income, contact your tax adviser or the ATO.

Split or merged depreciating assets

If a depreciating asset you hold is split into 2 or more assets, or if a depreciating asset or assets you hold is or are merged into another depreciating asset, you are taken to have stopped holding the original depreciating asset(s) and to have started holding the split or merged asset(s). However, a balancing adjustment event does not occur just because depreciating assets are split or merged.

An example of splitting a depreciating asset is the removal of a CB radio from a truck and its installation in a residence.

After depreciating assets are split or merged, each new asset must satisfy the definition of a depreciating asset if the UCA rules are to apply to it. For each depreciating asset you have started to hold, you need to establish the effective life and cost.

The first element of cost for each of the split or merged depreciating assets is a reasonable proportion of the adjustable values of the original asset(s) just before the split or merger and the same proportion of any costs of the split or merger.

If a balancing adjustment event occurs to merged or split depreciating asset(s)—for example, on sale—the balancing adjustment amount is reduced:

- to the extent the asset has been used for a non-taxable purpose
- by any amount that is reasonably attributable to use for a non-taxable purpose of the original depreciating asset(s) before the split or merger.

This reduction is not required if the depreciating asset is mining, quarrying or prospecting information.

Low-value pools

From 1 July 2000, an optional low-value pooling arrangement for plant was introduced. It applied to certain plant costing less than $1000 or having an undeducted cost of less than $1000. This plant could be allocated to a low-value pool and depreciated at statutory rates.

The UCA adopts most of the former rules for low-value pools. From 1 July 2001, the decline in value of certain depreciating assets can be calculated through a low-value pool.

A low-value pool created before 1 July 2001 continues and is treated as if it were created under the UCA. The closing balance of the pool worked out under the former rules is used to start working out the decline in value of the depreciating assets in the pool under the UCA rules.

Under the UCA, you can allocate low-cost assets and low-value assets to a low-value pool. A low-cost asset is a depreciating asset whose cost as at the end of the income year in which the asset's start time occurs is less than $1000 (after GST credits or adjustments). A low-value asset is a depreciating asset that is not a low-cost asset but:

- which has an opening adjustable value of less than $1000
- for which you have calculated any available deductions from a decline in value determined under the diminishing value method.

The following depreciating assets cannot be allocated to a low-value pool:

- low-value assets for which you have calculated any available deductions from a decline in value determined under the prime cost method
- horticultural plants (including grapevines)
- assets for which you can deduct amounts under the STS—see **STS taxpayers** on page 25
- assets that cost $300 or less for which you can claim an immediate deduction—see **Immediate deduction for certain depreciating assets costing $300 or less** on page 9
- certain depreciating assets used in carrying on research and development activities.

Allocating depreciating assets to a low-value pool

A low-value pool is created when you first choose to allocate a low-cost or low-value asset to the pool.

When you allocate an asset to the pool, you must make a reasonable estimate of the percentage of your taxable use of the asset over its effective life (for a low-cost asset) or the effective life remaining at the start of the income year in which it was allocated to the pool (for a low-value asset). This percentage is known as the asset's **taxable use percentage**.

It is this taxable use percentage of the cost that is written off through the low-value pool.

EXAMPLE

Working out the taxable use percentage

Kate allocates a low-cost asset to a low-value pool. The asset has an effective life of 3 years. Kate intends to use the asset 90 per cent for taxable purposes in the first year, 80 per cent in the 2nd year and 70 per cent in the 3rd year. The taxable use percentage is the average of these estimates; that is, 80 per cent.

Once you have allocated an asset to the pool, you cannot vary your estimate of the taxable use percentage even if the actual use of the asset turns out to be different from your estimate.

Once you choose to create a low-value pool and a low-cost asset is allocated to the pool, you must pool all other low-cost assets you start to hold in that income year and in later income years. However, this rule does not apply to low-value assets. You can decide whether to allocate low-value assets to the pool on an asset-by-asset basis.

Once you have allocated an asset to the pool, it remains in the pool.

Working out the decline in value of depreciating assets in a low-value pool

Once an asset is allocated to a low-value pool, it is not necessary to work out its adjustable value or decline in value separately. Only one annual calculation for the decline in value for all of the depreciating assets in the pool is required.

The deduction for the decline in value of depreciating assets in a low-value pool is worked out using a diminishing value rate of 37.5 per cent.

The deduction for low-cost assets you allocate to the pool for the income year is worked out at a rate of 18.75 per cent or half the pool rate. Halving the rate recognises that assets may be allocated to the pool throughout the income year and eliminates the need to make separate calculations for each asset based on the date it was allocated to the pool.

To work out the decline in value of the depreciating assets in a low-value pool, add:

- 18.75 per cent of:
  - the taxable use percentage of the cost of low-cost assets you have allocated to the pool for the income year and
  - the taxable use percentage of any amounts included in the second element of cost of all assets in the pool at the end of the previous year and of low-value assets allocated to the pool for the current year

  and
- 37.5 per cent of:
  - the closing pool balance for the previous income year and
  - the taxable use percentage of the opening adjustable value of any low-value assets allocated to the pool for the income year.

EXAMPLE

Working out the decline in value of depreciating assets in a low-value pool (ignoring any GST impact)

During the 2001–02 income year, John bought a printer for $990. John allocated low-cost assets to a low-value pool in the 2000–01 income year so now he must allocate the printer to the pool because it too is a low-cost asset. He estimates that only 60 per cent of its use will be for taxable purposes. He, therefore, allocates only 60 per cent of the cost of the printer to the pool; that is, $594.

Assume that at the end of the 2000–01 income year, John had a low-value pool with a closing pool balance of $5000. John's deduction for the decline in value of the assets in the pool for the 2001–02 income year would be $1986. This is worked out as follows:

18.75 per cent of the taxable use percentage of the cost of the printer allocated to the pool during the year (18.75% x $594)	**$ 111**
***plus* 37.5 per cent of the closing pool balance for the previous year (37.5% x $5000)**	**$1 875**

The closing balance of a low-value pool is:

- the closing pool balance for the previous income year *plus*
- the taxable use percentage of the cost of any low-cost assets allocated to the pool for the income year *plus*
- the taxable use percentage of the opening adjustable value of low-value assets allocated to the pool for the income year *plus*
- the taxable use percentage of any amounts included in the second element of cost of assets in the pool for the income year (these would be all assets in the pool at the end of the previous year and low-value assets allocated for this year) *less*
- the decline in value of the assets in the pool for the income year.

EXAMPLE

Working out the closing balance of a low-value pool (ignoring any GST impact)

Following on from the previous example on page 19, assuming that John made no additional allocations to or reductions from his low-value pool, the closing balance of the pool for the 2001–02 income year would be $3608:

Closing pool balance for the 2000–01 income year	**$5 000**
***plus* the taxable use percentage of low-cost assets allocated for the year (new printer)**	**$594**
***less* the decline in value of the assets in the pool for the year**	**($1 986)**

Balancing adjustment event for a depreciating asset in a low-value pool

If a balancing adjustment event occurs for a depreciating asset in a low-value pool, the amount of the closing pool balance for that year is reduced by the taxable use percentage of the asset's termination value. If that amount exceeds the closing pool balance, reduce the closing pool balance to zero and include the excess in assessable income.

A capital gain or capital loss may also arise if the asset is not used wholly for a taxable purpose. The difference between the asset's cost and its termination value that is attributable to the estimated non-taxable use of the asset is treated as a capital gain or capital loss.

EXAMPLE

Disposal of a depreciating asset in a low-value pool (ignoring any GST impact)

Following on from the previous examples, during the 2002–03 income year John sells the printer for $500. Because he originally estimated that the printer would only be used 60 per cent for taxable purposes, the closing balance of the pool is reduced by 60 per cent of the termination value of $500; that is $300.

A capital loss of $196 also arises. As the printer's taxable use percentage is 60 per cent, 40 per cent of the difference between the asset's cost ($990) and its termination value ($500) is treated as a capital loss.

Assuming that John made no additional allocations to or reductions from his low-value pool, the closing balance of the pool for the 2002–03 income year is $1955:

Closing pool balance for the 2001–02 income year	**$3 608**
***less* the decline in value of the assets in the pool for the year (37.5% x $3608)**	**($1 353)**
***less* the taxable use percentage of the termination value of pooled assets that were disposed of during the year**	**($300)**

To help you work out your deductions for depreciating assets in a low-value pool, a worksheet is provided on page 32.

In-house software

In-house software is computer software, or a right to use computer software (for example, a licence), that you acquire or develop (or have another entity develop) for your use in performing the functions for which it was developed and for which no amount is deductible outside the UCA.

Expenditure to develop software for exploitation of the copyright is not in-house software. The copyright is intellectual property which is a depreciating asset and the decline in value would be calculated using an effective life of 25 years and the prime cost method.

Any recoupment of the expenditure is included in your assessable income.

Units of in-house software

Expenditure incurred in acquiring in-house software will form part of the cost of the unit of in-house software acquired. It cannot be allocated to a software development pool.

Expenditure incurred on developing in-house software yourself (or having another entity develop it) may need to be allocated to a software development pool. If the expenditure cannot be allocated to a software development pool, it can be capitalised into the cost of a resulting unit of in-house software.

The general rules for depreciating assets apply to these units of in-house software. The decline in value is worked out using an effective life of 2½ years and the prime cost method.

You can claim an immediate deduction for expenditure on in-house software (not allocated to a software development pool) in one instance. This happens if, despite the fact that you incurred the expenditure with the intention of using the software for a taxable purpose, you have not used it or installed it ready for use and decide that you will never use it or install it ready for use.

The termination value of a unit of in-house software you still hold but stop using and expect never to use again or decide never to use is zero.

Software development pools

The choice of allocating expenditure in developing in-house software to a software development pool was available before 1 July 2001 and continues under the UCA.

Under the UCA rules, you can choose to allocate to a software development pool expenditure you incur in developing (or having developed) in-house software you intend to use solely for a taxable purpose. Once you do allocate expenditure on such in-house software to a pool, all such expenditure incurred thereafter—in that year or a later year—must be allocated to a software development pool. A different pool is created for each income year thereafter for expenditure for that year.

Expenditure on developing in-house software you do not intend to use solely for a taxable purpose and expenditure on acquiring in-house software cannot be allocated to a software development pool—see **Units of in-house software** on page 20.

If you are entitled to claim a GST input tax credit in relation to expenditure allocated to a software development pool, the expenditure in the pool for the income year in which you are entitled to the credit is reduced by the amount of the credit. Certain adjustments under the GST legislation in relation to expenditure allocated to a software development pool are treated as an outright deduction or income. Other adjustments reduce or increase the amount of the expenditure that has been allocated to the pool for the adjustment year.

You do not get any deduction for expenditure in a software development pool in the income year in which you incur it. You are allowed deductions at the rate of 40 per cent in each of the next 2 years and 20 per cent in the year after that.

If you have allocated software development expenditure on a project to a software development pool and the project is abandoned, the expenditure remains to be deducted as part of the pool.

If you have pooled in-house software development expenditure and you receive consideration for the software (for example, insurance proceeds on the destruction of the software), you must include that amount in your assessable income unless you can choose for roll-over relief to apply and do so. Choice of roll-over relief is only available where a change occurs in the holding of, or of interests in, the software—see **Roll-over relief** on page 27.

If the receipt arises from a non-arm's length dealing and the amount is less than the market value of what it was for, the amount of the receipt is taken to be that market value.

Common-rate pools

Before 1 July 2001, certain items of plant that had the same depreciation rate and were used solely for producing assessable income could be allocated to a common-rate pool so a single calculation of deductions could be made.

You cannot allocate depreciating assets to a common-rate pool under the UCA rules. However, if you have allocated plant to a common-rate pool before 1 July 2001, you can continue to claim deductions under the UCA. The pool is treated as a single depreciating asset and the decline in value is worked out using the following rules:

- the diminishing value method must be used
- the opening adjustable value and the cost of the asset on 1 July 2001 is the closing balance of the pool on 30 June 2001
- the effective life component of the diminishing value formula must be replaced with the pool percentage you used before the start of the UCA
- in applying the diminishing value formula for the income year in which the UCA starts, the base value is the opening adjustable value of the asset
- any second element costs of assets in the pool are treated as second element costs of the pool.

If a balancing adjustment event occurs for a depreciating asset in the pool or you stop using it wholly for taxable purposes, the asset is removed from the pool. The pool is treated as having been split into the removed asset and the remaining pooled items. The removed asset is then subject to the general rules for working out decline in value or balancing adjustment amounts. The cost of the removed asset and the remaining pool is worked out using the rules for working out the cost of a split asset—see **Split or merged depreciating assets** on page 18.

Primary production depreciating assets

The general principles of the UCA apply to assets used in primary production. Additionally, the UCA maintains the existing treatment of certain primary production depreciating assets.

The decline in value of the following primary producer depreciating assets is worked out using special rules:

- facilities used to conserve or convey water
- horticultural plants
- grapevines.

If the expenditure incurred arises from a non-arm's length dealing and is more than the market value of what it was for, the amount of the expenditure is taken to be that market value.

For depreciating assets deductible under these rules, you cannot use the general rules for working out decline in value or claim the immediate deduction for depreciating assets costing $300 or less.

If you are a primary producer and an STS taxpayer, you can choose to work out your deductions for water facilities under either the STS capital allowance rules or the UCA rules. However, you must use the UCA rules for deductions for horticultural plants and grapevines. For more information about STS taxpayers, see **STS taxpayers** on page 25.

Any recoupment of expenditure on primary production depreciating assets is included in your assessable income.

For more information on primary production depreciating assets, refer to the publication *Information for primary producers*. To find out how to get this publication, see the inside front cover.

Primary producers may also be able to claim deductions for capital expenditure on landcare operations, electricity connections and telephone lines—see **Capital expenditure of primary producers and other landholders** in the next column.

Capital expenditure deductible under the UCA

The UCA adopts the existing rules for deducting certain capital expenditure and also introduces new deductions for some capital expenditure that did not previously attract a deduction. Most of these deductions are only available if the expenditure does not form part of the cost of a depreciating asset.

The following types of capital expenditure are deductible under the UCA:

- landcare operations, electricity connections or telephone lines incurred by primary producers and other landholders—see **Capital expenditure of primary producers and other landholders** in the next column
- environmental protection activities—see **Environmental protection activities** on page 23
- exploration and prospecting—see **Mining and quarrying and minerals transport** on page 24
- rehabilitation of mining and quarrying sites—see **Mining and quarrying and minerals transport** on page 24
- petroleum resource rent tax—see **Mining and quarrying and minerals transport** on page 24
- certain capital expenditure directly connected with a project—see **Project pools** on page 24
- certain business related costs—see **Business related costs—section 40-880 deductions** on page 25.

Generally, to work out your deductions you need to reduce the expenditure by the amount of any GST input tax credits you are entitled to claim in relation to the expenditure. Increasing or decreasing adjustments that relate to the expenditure are allowed as a deduction or included in assessable income, respectively. Special rules apply to input tax credits on expenditure allocated to a project pool—see **Project pools** on page 24.

STS taxpayers other than primary producers may deduct capital expenditure under these UCA rules only if the expenditure is not part of the cost of a depreciating asset—see **STS taxpayers** on page 25.

Capital expenditure of primary producers and other landholders

The UCA maintains the existing treatment of certain capital expenditure of primary producers and other landholders.

A deduction is available for capital expenditure incurred by primary producers or in carrying on a rural business on:

- landcare operations
- connection of a mains electricity cable to a metering point or the upgrading of a connection, provided the electricity is used for a taxable purpose
- a telephone line brought onto land used in a primary production business.

Such capital expenditure may give rise to a depreciating asset. However, if the expenditure is deductible under these provisions, you cannot use the general rules for working out decline in value or claim the immediate deduction for depreciating assets costing $300 or less. If you are a primary producer and an STS taxpayer, you can choose to work out your deductions for these depreciating assets using either the STS capital allowance rules or the UCA rules. For more information about STS taxpayers, see **STS taxpayers** on page 25.

Landcare operations

You can claim a deduction in the year you incur capital expenditure on a landcare operation for land in Australia.

The deduction is available where the land is used wholly for either:

- a primary production business or
- carrying on a business for the purpose of producing assessable income from the use of rural land—except a business of mining or quarrying,

and is reduced to the extent it is not.

A landcare operation is one of the following operations:

- eradicating or exterminating animal pests from the land
- eradicating, exterminating or destroying plant growth detrimental to the land

- preventing or combating land degradation other than by the use of fences
- erecting fences to keep out animals from areas affected by land degradation to prevent or limit further damage and assist in reclaiming the areas
- erecting fences to separate different land classes in accordance with an approved land management plan
- constructing a levee or similar improvement
- constructing drainage works—other than the draining of swamps or low-lying areas—to control salinity or assist in drainage control.

No deduction is available if the capital expenditure is on plant unless it is on certain fences, dams or other structural improvements. The decline in value of plant not deductible under the landcare provisions is worked out using the general rules for working out decline in value—see **Working out decline in value** on page 4.

In each case, apart from the construction of a levee, the operation must be carried out primarily and principally for the purpose stated. If a levee is constructed primarily and principally for water conservation, it would be a facility used to conserve or convey water and no deduction would be allowable under these rules. The decline in value of the asset would need to be worked out under the rules for primary production depreciating assets—see **Primary production depreciating assets** on page 21.

If you are carrying on a primary production business on the land, you may claim the deduction even if you are a lessee.

If the expenditure incurred arises from a non-arm's length dealing and is more than the market value of what it was for, the amount of the expenditure is taken to be that market value.

These deductions are not available in calculating the net income or loss of a partnership. The expenditure is allocated to each partner and deducted against the partner's income.

Any recoupment of the expenditure is included in your assessable income.

Electricity connections and telephone lines

You can claim a deduction over 10 years for capital expenditure incurred in connecting:

- mains electricity to land on which a business is carried on or in upgrading an existing connection to that land
- a telephone line to land being used to carry on a primary production business.

If the expenditure incurred arises from a non-arm's length dealing and is more than the market value of what it was for, the amount of the expenditure is taken to be that market value.

These deductions are not available in calculating the net income or loss of a partnership. The expenditure is allocated to each partner and deducted against the partner's income.

Any recoupment of the expenditure is included in your assessable income.

Environmental protection activities

You can get an immediate deduction for expenditure to the extent that you incur it for the sole or dominant purpose of carrying on environmental protection activities (EPA). EPA are activities undertaken to prevent, fight or remedy pollution, or to treat, clean up, remove or store waste from your earning activity. Your earning activity is one you carried on, carry on or propose to carry on for the purpose of:

- producing assessable income (other than a net capital gain)
- exploration or prospecting, or
- mining site rehabilitation.

You may also claim a deduction for cleaning up a site on which a predecessor carried on substantially the same business.

The deduction is not available for:

- EPA bonds and security deposits
- expenditure for acquiring land
- expenditure for constructing or altering buildings, structures or structural improvements
- expenditure to the extent that you can deduct an amount for it under another provision.

Expenditure on EPA that is also an environmental impact assessment of your project is not deductible as expenditure on EPA. Instead, it could be deductible over the life of the project using a pool—see **Project pools** on page 24.

Also, expenditure which forms part of the cost of a depreciating asset is not deductible as expenditure on EPA if a deduction is available for the decline in value of the asset.

If the expenditure arises from a non-arm's length transaction and is more than the market value of what it was for, the amount of the expenditure is instead taken to be that market value.

Any recoupment of the expenditure is included in your assessable income for the year in which you receive it.

Note that expenditure incurred on or after 19 August 1992 on certain earthworks constructed as a result of carrying out EPA can be written off at a rate of 2.5 per cent under the provisions for capital works expenditure.

Mining and quarrying and minerals transport

From 1 July 2001, deductions for the decline in value of depreciating assets used in mining and quarrying and in minerals transport are worked out using the general rules—see **Working out decline in value** on page 4. However, the decline in value of a depreciating asset you first use for exploration or prospecting for minerals (including petroleum) or quarry materials obtainable by activities carried on for the purpose of producing assessable income can be its cost. This means you can deduct the cost of the asset in the year in which you start to use it for such activities to the extent the asset is used for a taxable purpose.

An immediate deduction is available for payments of petroleum resource rent tax and for capital expenditure which does not form part of the cost of a depreciating asset and is incurred on:

- exploration or prospecting for minerals (including petroleum) or quarry materials obtainable by activities carried on for the purpose of producing assessable income, or
- rehabilitation of your mining or quarrying sites.

If the expenditure arises from a non-arm's length transaction and is more than the market value of what it was for, the amount of the expenditure is instead taken to be that market value.

Any recoupment of the expenditure is included in assessable income.

Expenditure incurred after 30 June 2001 which does not form part of the cost of a depreciating asset and is not otherwise deductible may be deductible as a project amount through a project pool. This applies to mining capital expenditure directly connected with carrying on mining operations and transport capital expenditure directly connected with carrying on the associated business.

Mining capital expenditure is capital expenditure incurred on:

- carrying out eligible mining or quarrying operations
- site preparation
- necessary buildings or improvements
- provision of water, light or power to the site of those operations
- building used directly for operating or maintaining treatment plant
- buildings and improvements for storing minerals or quarry materials for treatment
- housing and welfare—except for quarrying operations.

Transport capital expenditure includes capital expenditure on:

- a railway, road, pipeline, port or other facility used principally for mining or quarrying transport
- obtaining a right to construct or install such a facility
- compensation for damage for constructing or installing such a facility
- earthworks, bridges, tunnels or cuttings
- contributions you make in carrying on business to someone else's expenditure on the above items.

For information on how to work out deductions for such expenditure using a project pool, see **Project pools** below.

Special transitional rules ensure that amounts of undeducted expenditure as at the end of 30 June 2001 incurred under the former special provisions for the mining and quarrying and mineral transport industries remain deductible over the former statutory write-off periods—for example, over the lesser of 10 years and the life of the mine.

Similarly, that former statutory write-off continues to apply to expenditure incurred after 30 June 2001 if:

- it would have qualified for deduction under those former special provisions
- it is a cost of a depreciating asset that you started to hold under a contract entered into before 1 July 2001 or otherwise started to hold or commenced to construct before that day.

Finally, exploration or prospecting expenditure incurred after 30 June 2001 that is a cost of a depreciating asset that you started to hold under a contract entered into before 1 July 2001 or otherwise started to hold or commenced to construct before that day is deductible at the time incurred.

Project pools

The UCA allows certain capital expenditure incurred after 30 June 2001 which is directly connected with a project you carry on, or propose to carry on, for a taxable purpose to be written off over the life of the project using a pool.

Such capital expenditure, known as a project amount, must be incurred on:

- creating or upgrading project associated community infrastructure
- site preparation for depreciating assets (other than to drain swamp or low-lying land or to clear land for horticultural plants and grapevines)
- feasibility studies for the project
- environmental assessments for the project
- obtaining information associated with the project
- seeking to obtain a right to intellectual property or
- ornamental trees or shrubs.

Project amounts also include mining capital expenditure and transport capital expenditure—see **Mining and quarrying and minerals transport** on page 24.

The expenditure must not be otherwise deductible or form part of the cost of a depreciating asset.

If the expenditure incurred arises from a non-arm's length dealing and is more than the market value of what it was for, the amount of the expenditure is taken to be that market value.

The deduction for a project pool commences when the project begins to operate and is calculated as follows:

$$\frac{\text{Pool value} \times 150\%}{\text{DV project pool life}}$$

The **pool value** at a particular time is, broadly, the sum of the project amounts allocated to the pool up to that time less the sum of the deductions you have claimed for the pool in previous years or could have claimed had the project operated wholly for a taxable purpose.

The **DV project pool life** is the project life or, if that life has been recalculated, the most recently recalculated project life. The **project life** is worked out by estimating how long it will be from when the project starts to operate until it stops operating.

There is no need to pro-rate the deductions where the project starts or permanently stops operating during a year or for project amounts incurred during a year. However, the deduction is reduced to the extent to which the project does not operate for a taxable purpose.

EXAMPLE

Working out deductions for a project pool (ignoring any GST impact)

Before constructing an office block, a building company undertook an environmental assessment at a cost of $30 000. The construction of the building was completed on 17 August 2001 and the company started leasing floor space from that date. The company expects that the building will produce rental income for the next 35 years so this is the 'project life'. The company can start deducting the amount incurred on the environmental assessment for the income year the project started operating. This would be the 2001–02 income year, the year the company started leasing floor space. The company works out its deductions for the 2001–02 and 2002–03 income years as follows:

2001–02 $\$30\,000 \times \frac{150\%}{35} = \$1286$

2002–03 $\$28\,714 \times \frac{150\%}{35} = \$1231$

If you are entitled to claim a GST input tax credit for expenditure allocated to a project pool, the pool value in the income year in which you are, or become, entitled to the credit is reduced by the amount of the credit. Certain increasing or decreasing adjustments in relation to expenditure allocated to a project pool may also affect the pool value.

If the project is abandoned, sold or otherwise disposed of in an income year, the project's pool value at the time is an allowable deduction.

Any recoupment of the expenditure is included in your assessable income for the year in which you receive it.

Your assessable income will also include amounts received for the abandonment, sale or other disposal of the project and any other capital amounts you receive in relation to an amount allocated to a project pool or in relation to something on which a project amount is expended.

If the receipt arises from a non-arm's length dealing and the amount is less than the market value of what it was for, the amount of the receipt is taken to be that market value.

Business related costs—section 40-880 deductions

Certain business related costs incurred after 30 June 2001 are now deductible to the extent that the business is or was carried on for a taxable purpose. The costs must not be otherwise deductible or form part of the cost of a depreciating asset or of land. The following types of business related expenditure may now qualify for deduction:

- business establishment costs
- business restructuring costs
- business equity raising costs
- costs of defending your business against a takeover
- costs to the business of unsuccessfully attempting a takeover
- costs of liquidating a company that carried on a business and of which you are a shareholder
- costs of ceasing to carry on the business.

If the expenditure arises from a non-arm's length dealing and is more than the market value of what it was for, the amount of the expenditure is taken to be that market value.

You deduct 20 per cent of the expenditure in the year you incur it and in each of the following 4 years.

Any recoupment of the expenditure is included in your assessable income.

STS taxpayers

The Simplified Tax System (STS) is an alternative method of determining taxable income for eligible taxpayers. It began on 1 July 2001.

You are eligible to be an STS taxpayer for an income year if:

- you carry on a business
- you have an STS average turnover of less than $1 million: the STS average turnover includes the turnover of any entities you are 'grouped with'

- you together with any entities you are 'grouped with' have depreciating assets with a total adjustable value of less than $3 million at the end of the year.

The STS contains its own simplified capital allowance rules. If you are an eligible taxpayer and elect to enter the STS, you will generally calculate deductions for your depreciating assets using these rules.

In general, most:
- depreciating assets costing less than $1000 each ('**low-cost assets**') can be written off immediately
- other depreciating assets with an effective life of less than 25 years are pooled in a general STS pool and deducted at the rate of 30 per cent
- depreciating assets with an effective life of 25 years or more are pooled in a **long-life STS pool** and deducted at the rate of 5 per cent
- newly acquired assets are deducted at either 15 per cent or 2.5 per cent in the first year, regardless of when they were acquired during the year.

More information on working out deductions for depreciating assets under the STS rules is provided in the publication *The Simplified Tax System—a guide for tax agents and small businesses*. To find out how to get this publication, see the inside front cover.

Assets for which deductions are claimed under the UCA

For certain depreciating assets, deductions must be claimed under the UCA rather than under the STS rules:
- assets that are leased out, or will be leased out, for more than 50 per cent of the time on a depreciating asset lease—this does not apply to depreciating assets subject to hire purchase agreements, or short-term hire agreements on an hourly, daily, weekly or monthly basis: depreciating assets used in rental properties are generally excluded from the STS capital allowance rules on the basis that they are subject to a depreciating asset lease
- assets allocated to a low-value or a common-rate pool before entering the STS: those assets must remain in the pool and deductions must be claimed under the UCA rules
- horticultural plants (including grapevines)
- in-house software where the development expenditure is allocated to a software development pool—see **Software development pools** on page 20.

Capital expenditure deductible under the UCA

As the STS capital allowance rules apply only to depreciating assets, certain capital expenditure incurred by an STS taxpayer that does not form part of the cost of a depreciating asset may be deducted under the UCA rules for deducting capital expenditure. This includes capital expenditure on certain business related costs and amounts directly connected with a project—see **Capital expenditure deductible under the UCA** on page 22 for more information.

In-house software

Under the UCA rules, you can choose to allocate to a software development pool expenditure you incur in developing (or having developed) in-house software you intend to use solely for a taxable purpose. Once you have allocated expenditure on such software to a pool, all such expenditure incurred thereafter—in that year or in a later year—must also be allocated to a pool. A different software development pool must be created for each year in which you have such expenditure—see **In-house software** on page 20.

If you have allocated such expenditure to a software development pool either before or since entering the STS, you must again allocate such expenditure to a software development pool and calculate your deductions under the UCA.

If you have not previously allocated such expenditure to a software development pool and you choose not to do so this year or if the expenditure was incurred in developing in-house software which you do not intend using solely for a taxable purpose, you can capitalise it into the cost of the unit of software developed and claim deductions for the unit of in-house software under the STS rules when it starts to be used or is installed ready for use for a taxable purpose.

Deductions for in-house software acquired off the shelf by an STS taxpayer for use in their business are available under the STS rules. For example, an item costing less than $1000 will qualify for an outright deduction.

Primary producers

An STS taxpayer can choose to claim deductions under either the STS rules or the UCA rules for certain depreciating assets used in the course of carrying on a business of primary production. The choice is available for water facilities. It is also available for depreciating assets relating to landcare operations, electricity connections and telephone lines—see pages 22 and 23.

You can choose to claim your deductions under the STS rules or UCA rules for each depreciating asset. Once you have made the choice, it cannot be changed.

Record keeping

You must keep the following information for a depreciating asset:
- the first and second elements of cost
- the opening adjustable value for the income year
- any adjustments made to cost or adjustable value
- the date you started holding the asset and its start time

- the rate or effective life used to work out the decline in value
- the method used to work out the decline in value
- the amount of your deduction for the decline in value and any reduction for use of the asset other than for a taxable purpose
- the adjustable value at the end of the income year
- any recoupment of cost you have included in assessable income
- if a balancing adjustment event occurs for the asset during the year—the date of the balancing adjustment event, termination value, adjustable value at that time, the balancing adjustment amount, any reduction of the balancing adjustment amount and details of any roll-over or balancing adjustment relief.

You must also keep:

- details of how you worked out the effective life of a depreciating asset where you have not adopted the effective life determined by the Commissioner
- if you have recalculated the effective life of an asset—the date of the recalculation, the recalculated effective life, the reason for the recalculation and details of how you worked out the recalculated effective life
- original documents such as suppliers' invoices and receipts for expenditure on the depreciating asset.

Additional record keeping requirements apply if you acquire an asset from an associate or if you acquire a depreciating asset but the user is the same or is an associate of the former user—see **Depreciating asset acquired from an associate** on page 8 and **Holder changes but user same or associate of former user** on page 9.

Failure to keep proper records will attract penalties.

Low-value pools

For depreciating assets in a low-value pool, you need to keep the following details—some details relate to the assets and some to the pool:

- the start time of assets in the pool and the date you started holding them
- the closing pool balance at the end of the previous income year
- any second elements of cost incurred for the income year for assets in the pool at the end of the previous income year
- the opening adjustable value of any low-value assets you have allocated to the pool for the income year
- the first element of cost of any low-cost assets allocated to the pool for the income year
- the second element of cost of low-cost assets and low-value assets allocated for the income year
- the taxable use percentage of each amount added to the pool for the income year
- the termination value and taxable use percentage for any assets in the pool for which a balancing adjustment event occurred during the income year and the date of the balancing adjustment event
- the closing pool balance
- the decline in value
- any amount included in assessable income because the taxable use percentage of the termination value exceeds the closing pool balance
- any recoupment of cost you have included in assessable income.

Because a capital gain or capital loss may arise when a balancing adjustment event occurs for a depreciating asset you expect to use for a non-taxable purpose, for a depreciating asset you have allocated to a low-value pool and expect to use for a non-taxable purpose, you must keep the following information:

- the first and second elements of cost
- termination value
- the taxable use percentage.

Roll-over relief

If automatic roll-over relief applies—see **Roll-over relief** on page 17—the transferor must give the transferee a notice containing enough information for the transferee to work out how the UCA rules apply to the depreciating asset. Generally, this needs to be done within 6 months of the end of the transferee's income year in which the balancing adjustment event occurred. The transferee must keep a copy of the notice for 5 years after

- the asset is disposed of or
- the asset is lost or destroyed

whatever happens earlier.

If a transferor and transferee jointly choose roll-over relief, the decision must be in writing and must contain enough information for the transferee to work out how the UCA rules apply to the depreciating asset. Generally, the choice needs to be made within 6 months of the end of the transferee's income year in which the balancing adjustment event occurred. The transferor must keep a copy of the agreement for 5 years after the balancing adjustment event occurred. The transferee must keep a copy for 5 years after the next balancing adjustment event that occurs to the asset.

Completing the *Capital allowances schedule 2002*

Unless you are an STS taxpayer or an individual taxpayer not carrying on a business, you need to complete a *Capital allowances schedule 2002* if you had:

more than $1000 at any of the following labels on your income tax return:

Label	Where label found
Depreciation expenses	All tax returns except fund tax return
Deduction for decline in value of depreciating assets	Company and fund tax returns only
Deduction for project pool	All tax returns except fund tax return
Business deduction for project pool	Business and professional items section of tax return for individuals
Low-value pool deduction	Tax return for individuals only

OR

more than $5000 at either of the following labels on your income tax return:

Label	Where label found
Intangible depreciating assets first deducted	All tax returns
Other depreciating assets first deducted	All tax returns

You should use *Worksheet 1—depreciating assets* and *Worksheet 2—low-value pool* to help you complete your income tax return and the schedule. These worksheets are on pages 31 and 32.

For more information about the *Capital allowances schedule 2002*, see the *Capital allowances schedule instructions*. To find out how to get these publications, see the inside front cover.

Guidelines for using the depreciating assets worksheet

The depreciating assets worksheet (worksheet 1) is on page 31.

Primary production and **Non-primary production**—Use a separate worksheet for each category.

Cost—The cost of a depreciating asset includes first and second elements of cost. The cost of an asset can be adjusted in certain circumstances, such as if the first element of a car's cost exceeds the car limit. If the cost of the asset has been adjusted, include the adjusted cost in this column—see **The cost of a depreciating asset** on page 12.

Opening adjustable value and **Adjustable value at end of year**—The adjustable value of a depreciating asset at any time is its cost (first and second elements) reduced by any decline in value up to that time. The opening adjustable value of an asset for an income year is the same as its adjustable value at the end of the previous income year.

Balancing adjustment events—A balancing adjustment event occurs for a depreciating asset if you stop holding it (for example, if you sell it) or you stop using it—see **What happens if you no longer hold or use a depreciating asset?** on page 14.

Termination value—Generally, the termination value is what you receive for the asset under the balancing adjustment event, such as the proceeds from selling the asset—see **Termination value** on page 15.

Balancing adjustment amounts—If the asset's termination value is greater than its adjustable value, the excess is an assessable balancing adjustment amount. If the termination value is less than the adjustable value, the difference is a deductible balancing adjustment amount. If the asset is used for non-taxable purposes, the balancing adjustment amount is reduced and a capital gain or capital loss may arise—see **Depreciating asset used for non-taxable purpose** on page 15.

Balancing adjustment relief—This is a reference to the offsetting of otherwise assessable balancing adjustment amounts, such as for involuntary disposals—see **Involuntary disposal of a depreciating asset** on page 17.

Decline in value—There are 2 methods of working out the decline in value of a depreciating asset—**prime cost** and **diminishing value**—see **Methods of working out decline in value** on page 5.

Effective life or **percentage rate**—Both the prime cost and diminishing value methods are based on a depreciating asset's effective life—see **Effective life** on page 10. However, if you used accelerated rates of depreciation for an item of plant before 1 July 2001 or could have had you used the plant for producing assessable income, you continue to use accelerated rates to work out the decline in value rather than the effective life—see **Accelerated depreciation** on page 7. A list of accelerated rates is provided—see **Accelerated rates of depreciation** on page 29.

Percentage of non-taxable use—This is the percentage of your non-taxable use (for example, private use) of the asset during the income year.

Deduction for decline in value—Your deduction for the decline in value of the asset is the decline in value reduced to the extent you used the asset for a non-taxable purpose. Your deduction may also be reduced if the asset is a leisure facility or a boat—see **Decline in value of depreciating asset used for non-taxable purpose** on page 8.

The letters **G**, **H**, **I**, **J** and **K** on the worksheet correspond to labels on the *Capital allowances schedule 2002*. The worksheet will assist you to complete the schedule—see **Completing the *Capital allowances schedule 2002*** on page 27.

Extracts from Taxation Ruling IT 2685 and Taxation Ruling TR 2000/18—effective lives

Item	Effective life in years given in IT 2685	TR 2000/18
Air conditioners		
– ducted	15	13 1/3
– room units	10	10
Alarms	20	20
Calculators, electronic	10	10
Carpets, business premises	5	5
Cash registers	7	6 2/3
Chainsaw	3	2
Computers	5	4
Curtains and drapes	7	6 2/3
Electric hand tools	5	5
Electric vacuum cleaners	10	10
Furniture	15	13 1/3
Hot water service	20	20
Libraries	10	10
Lights, fluorescent	20	20
Loose hand tools	full replacement cost	5
Motor vehicles		
buses		
– carry 9 or more	7	6 2/3
– carry fewer than 9	7	6 2/3
cars		
– taxis	4	4
– other	7	6 2/3
trucks		
– carry 1 tonne or more	7	6 2/3
– carry less than 1 tonne	7	6 2/3
Photocopiers	10	5
Television sets	10	10
Washing machines	7	6 2/3
Houses and flats let furnished		
blind, venetian	20	20
carpets	10	10
curtains and drapes	7	6 2/3
electric bed	15	13 1/3
electric clock	15	13 1/3
electric heater	10	10
furniture and fittings	15	13 1/3
garbage unit, compacting	7	6 2/3
hot water service	20	20
lawn mowers		
– motor	7	6 2/3
– self-propelled	5	5
linoleum and similar floor coverings	10	10
microwave ovens	7	6 2/3
radios	10	10
refrigerators	15	13 1/3
stoves	20	20
television sets	10	10
vacuum cleaners	10	10
washing machines	7	6 2/3

NOTE To find out which effective life you should use for a particular item—see **Effective life** on page 10.

Accelerated rates of depreciation

You use the rate that corresponds to the effective life of the item of plant. The following tables show the appropriate rates.

For most general items of plant the rates are as follows.

Effective life in years	Prime cost rate %	Diminishing value rate %
Less than 3	100	–
3 to less than 5	40	60
5 to less than 6 2/3	27	40
6 2/3 to less than 10	20	30
10 to less than 13	17	25
13 to less than 30	13	20
30 or more	7	10

For most cars and motor cycles the following rates apply.

Effective life in years	Prime cost rate %	Diminishing value rate %
Less than 3	100	–
3 to less than 5	33	50
5 to less than 6 2/3	20	30
6 2/3 to less than 10	15	22.5
10 to less than 13	10	15
13 to less than 20	8	11.25
20 to less than 40	5	7.5
40 or more	3	3.75

For employees' amenities, special minimum rates of 33 per cent prime cost or 50 per cent diminishing value apply. Employees' amenities means property used mainly to provide clothing cupboards, first aid, rest-room or recreational facilities and meals or facilities for meals for certain employees and their children.

Guidelines for using the low-value pool worksheet

The low-value pool worksheet (worksheet 2) is on page 32.

Description of low-value asset—In this column include a brief description of any low-value assets you allocated to the pool for the current year. A low-value asset is one that is not a low-cost asset but has an opening adjustable value of less than $1000 and for which you have worked out deductions using the diminishing value method.

Opening adjustable value of low-value asset—The adjustable value of a depreciating asset at any time is its cost (first and second elements) reduced by any decline in value up to that time. The opening adjustable value of an asset for an income year is the adjustable value at the end of the previous income year.

Taxable use percentage—When you allocate an asset to the pool, you must make a reasonable estimate of the percentage of your taxable use of the asset over its effective life (for a low-cost asset) or its effective life remaining at the start of the income year it was allocated to the pool (for a low-value asset).

Reduced opening adjustable value of low-value asset—This is the taxable use percentage of the opening adjustable value of a low-value asset you have allocated to the pool for the income year.

Description of low-cost asset or second element of cost of asset in pool—In this column include a brief description of any low-cost assets you allocated to the pool for the income year. A low-cost asset is one whose cost as at the end of the year in which the start time occurred is less than $1000. Also show in this column a description of any amounts included in the second element of cost of assets in the pool for the income year. These are all assets in the pool at the end of the previous year and low-value assets allocated for this year. The second element of an asset's cost is capital expenditure on the asset which is incurred after you start to hold it, such as a cost of improving the asset—see **The cost of a depreciating asset** on page 12.

Cost of low-cost asset and **second element of cost**—Include the cost after you have made any adjustments, such as for GST input tax credits—see **The cost of a depreciating asset** on page 12.

Reduced cost of low-cost asset or second element of cost—This is the taxable use percentage of the cost of low-cost assets you allocated to the pool for the income year or the taxable use percentage of any amounts included in the second element of cost of assets in the pool for the income year.

Balancing adjustment events—A balancing adjustment event occurs for a depreciating asset if you stop holding it (for example, if you sell it) or you stop using it—see **What happens if you no longer hold or use a depreciating asset?** on page 14.

Termination value—Generally, the termination value is what you receive for the asset under a balancing adjustment event, such as the proceeds from selling the asset—see **Termination value** on page 15.

Reduced termination value—This is the taxable use percentage of the asset's termination value. You use the taxable use percentage you estimated when the asset was allocated to the pool. This reduced termination value reduces the amount of the closing pool balance. If it exceeds the amount of the closing pool balance, reduce that balance to zero and include the excess in assessable income. If you use the asset for non-taxable purposes, a capital gain or capital loss may arise when a balancing adjustment event occurs for the asset—see **Balancing adjustment event for a depreciating asset in a low-value pool** on page 20.

The letters **L**, **M**, **N**, **O**, **P** and **Q** on the worksheet correspond to labels on the *Capital allowances schedule 2002*. The worksheet will assist you to complete the schedule—see **Completing the *Capital allowances schedule 2002*** on page 27.

Worksheet 1—depreciating assets

Primary production only ☐ Non-primary production only ☐

Description of asset	Date of acquisition	Cost	Opening adjustable value	Balancing adjustment events				Decline in value				Percentage non-taxable use	Deduction for decline in value		Adjustable value at end of year
				Date	Termination value	Balancing adjustment amounts		Effective life	Percentage rate	Prime cost	Diminishing value		Prime cost	Diminishing value	
						Assessable	Deductible								

Subtotal ▶ [ ] **H** [ ]

◀ Amount to be claimed as a deduction
Do not include in ***Total deduction for decline in value***

Totals ▶ **I** [ ] **J** [ ] **K** [ ]

Less balancing adjustment relief ▶ [ ]

Assessable income ▶ **G** [ ]
Do not deduct from ***Total deduction for decline in value***

Total deduction for decline in value ▶ [ ]

Worksheet 2—low-value pool

1 Description of low-value asset (LVA)	2 Opening adjustable value (OAV) of LVA	3 Taxable use percentage	4 Reduced OAV of LVA (2 x 3)	5 Description of low-cost asset (LCA) or second element of cost of asset in pool	6 Cost of LCA	7 Second element of cost	8 Taxable use percentage	9 Reduced cost of LCA or second element of cost (6 or 7 x 8)	Balancing adjustment events: 10 Description of asset for which balancing adjustment event occurred	11 Termination value (TV)	12 Taxable use percentage	13 Reduced TV (11 x 12)
Total ▶	N	Subtotal ▶	A	Totals ▶	M	O	Subtotal ▶	E		Q	◀ Totals ▶	H

Add closing pool balance for previous income year ▶ **L**

Sum of **A** and **L** ▶ **C**

C x 37.5% ▶ **D**

E x 18.75% ▶ **F**

Decline in value (**D** + **F**) ▶ **G**

Closing pool balance (**C** + **E** – **G** – **H**) ▶ **P***

* If amount at **P** would otherwise be negative, include that amount in your assessable income as a balancing adjustment amount and reduce the amount shown at **P** to zero.

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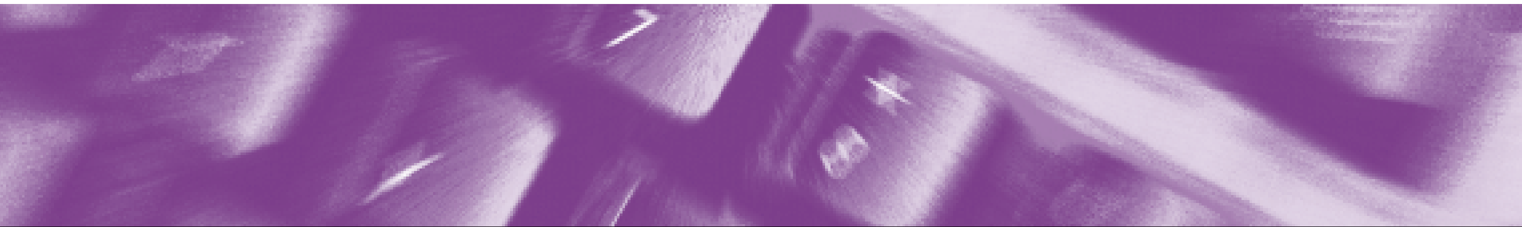

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