
TOWARDS A NEW POLICY FRAMEWORK FOR WASTING ASSETS

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A case for reform

What is a wasting asset?

1.1 An asset is most broadly defined as future economic benefits controlled by the taxpayer as a result of past transactions or past events. This definition encompasses tangible assets (both physical and financial) and intangible assets. It focuses on the economic interest of the taxpayer rather than formal ownership rules based on legal concepts. *Wasting assets* are those that, at the time they are acquired or created, can be reasonably expected to decline in value over time. This definition is similar to *depreciable assets* under Australian Accounting Standard AASB 1021 ‘Depreciation’, except that wasting assets may be current assets. For accounting purposes any decline in value for a current asset is not depreciated. Instead, it is brought to account when the asset is consumed or converted into cash generally within the 12 months after the end of the reporting period.

How are wasting assets taxed at present?

Current arrangements are complex and inconsistent

1.2 Wasting assets are a significant part of the tax base. The taxation of these assets bears on investment decisions and economic performance. The present method of dealing with wasting assets is complex, inconsistent and involves significant duplication.

1.3 The expected decline in value of wasting assets is generally recognised by a system of capital allowances which determine the amount of deduction available to a taxpayer each year in respect of that asset. *A Strong Foundation* illustrated in Figure 3.3 the wide range of capital allowances regimes in the existing law. The major provisions are summarised in Appendix A. In addition, two more sets of provisions — those relating to spectrum licences and computer software — have been announced by the Government but have not yet been enacted.

1.4 Figure 1.1 illustrates some of the inconsistencies between the various capital allowance regimes.

Figure 1.1: Capital allowances — some variations on a theme

Type of asset	Who may deduct?	Starting when?	Over how long?	Taxation upon disposal?
Plant	Owners and quasi-owners	Installed ready for use	Accelerated over effective life	Balancing adjustment, balancing charge offset plus CGT
Buildings	Owners, continuous lessees, and continuous quasi-owners	Constructed ready for use	25 or 40 years	Balancing deduction on destruction plus CGT
Films	Contributors of capital	Upon investment	100% in first year	Proceeds assessable
Mining	Payers carrying on operations	Upon investment	Lesser of estimated life or 10 years	Balancing adjustment plus CGT
Water conservation	Payers carrying on primary production business	Upon investment	3 years	CGT
Grapevines	Owners and quasi-owners carrying on primary production business	Upon investment	4 years	Balancing adjustment on destruction plus CGT

1.5 There are many inconsistencies in the various capital allowance write-off regimes. Some of the more notable are:

- some capital allowances are determined on the basis of the actual expenditure incurred by the taxpayer (for example, plant depreciation) whereas others are determined on the basis of the original cost of the asset (for example, buildings);
- under some capital allowance regimes (for example, plant depreciation) entitlement to deductions is based on ownership, but for others deduction entitlements are based on who incurred the expenditure;
- the write-off rate for some assets is based on the effective life of the asset (for example, plant depreciation, horticultural plants and some intellectual property) whereas for other assets it is determined using some other basis (for example, buildings);

- some assets, most notably plant, receive accelerated rates of write-off. What is and is not plant is not always clear and this creates uncertainty and leads to disputation;
- the diminishing value method of calculating deductions is only available under the plant depreciation provisions;
- only plant depreciation allows taxpayers to defer balancing charges by setting gains against the cost of replacement and other items of plant; and
- there are expenditures (*‘blackhole’* expenditures) that presently do not qualify for any write-off.

A strategy for reform

1.6 Clearly taxpayers should be entitled to deduct the cost of assets used up in the production of assessable income. The issue is how the deductions relating to the cost of an asset should be spread over the effective life of the asset. Effective life depreciation is directed at allowing the taxpayer to deduct an estimate of the actual decline in the value of the asset in each year. This chapter discusses the mechanisms that might be used to achieve this in a consistent way across the full range of wasting assets and what changes to the current system that might require.

1.7 The term ‘accelerated depreciation’ refers to the situation where the cost of the asset is deducted over a shorter period than its effective life. Such a system results in the taxpayer being allowed deductions for declines in the value of the asset greater than those actually occurring. This provides the taxpayer with a cash flow advantage. It is the equivalent of an interest free loan to the taxpayer from the government. The case for accelerated depreciation is discussed in the next chapter.

Adopt a consistent approach to write-off allowances

1.8 Figure 1.2 represents a possible consistent framework for write-off allowances.

1.9 Various design features need to be considered. The discussion will be structured around:

- entitlements to capital allowance write-offs;
- the appropriate cost base for deductions;
- when deductions should commence;
- over what period assets should be written off;
- what rules should apply to determine the period of write-off;
- whether there should be immediate write-off for small items;
- method of write-off (prime cost and/or diminishing value);
- what rules should apply upon disposal of an asset; and
- taxation treatment of blackhole expenditures.

Figure 1.2: An integrated model for capital allowances

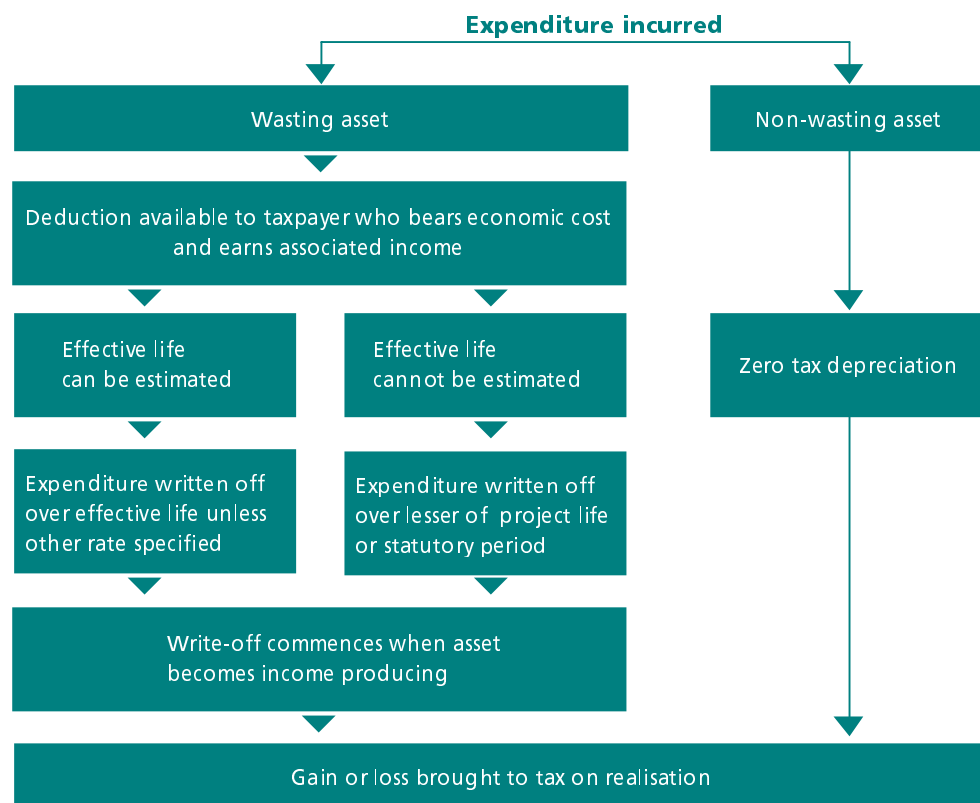
Type of asset	Who may deduct?	Starting when?	Over how long?	Taxation upon disposal?
All wasting assets	Taxpayer bearing economic cost	When investment becomes income producing	Effective life of asset (or statutory write-off period)	A unified balancing adjustment and CGT treatment

Note: Each of these design features is subject to consultation.

1.10 Figure 1.3 is a summary presentation of how a basic structure might operate.

1.11 Appendices B to D to this chapter discuss the current capital allowance provisions in the law. Provisions discussed are those relating to plant and equipment (Appendix B), buildings and structures (Appendix C) and mining and resources (Appendix D).

Figure 1.3: A standard capital allowances model



Key policy issues

Who should be entitled to deductions?

Current arrangements

1.12 Logically the taxpayer suffering the loss in value of the wasting asset should be entitled to the tax deductions. This may not always be the legal owner of the asset.

1.13 Under the existing law, entitlement to depreciation deductions for plant and some other major capital allowances depends on the taxpayer being the legal owner of the asset on which capital expenditure has been incurred and the asset being used for the purpose of producing assessable income. Entitlements under other capital allowances depend only on the taxpayer having incurred the expenditure for an income producing activity.

1.14 The ownership basis for depreciation and other capital allowances has created difficulties and commercial uncertainties. For example, because fixtures are part of the land, they are legally owned by the landowner. That

means in some cases a taxpayer that has incurred expenditure may not be allowed a deduction.

Option 1: Whoever incurs the expenditure to produce assessable income

1.15 One option is that the eligibility rules, as a primary test, would have regard to whether the taxpayer had incurred expenditure on an asset for purposes of assessable income production. Also relevant would be whether the taxpayer had the requisite economic interest in the asset and whether any other taxpayer was eligible to claim deductions.

1.16 Under this approach, it would make no difference to eligibility whether the taxpayer's economic interest in the asset was that of (legal) owner, or as acquirer under hire purchase, lease or some equivalent form of financing which creates the economic interest in the asset, provided the eligible taxpayer was the one that actually incurred the relevant expenditure.

1.17 Where a taxpayer's eligible capital expenditure gives rise to an interest in an asset as joint owner or tenant in common, the taxpayer would be entitled to capital allowances based on the taxpayer's interest in the future declining value of the asset. The capital expenditure would include moneys contributed:

- directly to jointly acquire or construct the property;
- indirectly under a financial arrangement (hire purchase or lease);
or
- indirectly by way of a capital contribution to a joint venture.

Option 2: Whoever qualifies under the accounting principle

1.18 Another option would require capital allowances to be recognised in accordance with the accounting principles in Australian Accounting Standard AASB 1021 'Depreciation'. This approach would require a taxpayer to recognise depreciation in relation to depreciable assets it controls that meet the recognition criteria. Assets would be defined as 'future economic benefits controlled by the taxpayer as a result of past transactions or other past events'.

1.19 The control of an asset would be the capacity to benefit from it in pursuit of the taxpayer's objectives and to deny or regulate the access of others to that benefit. An asset with physical substance which is expected to be used during more than one year may be depreciated when and only when it is probable that the future economic benefits embodied in it will eventuate and it possesses a cost or other value that can be measured reliably.

1.20 Under an accounting principles approach capital allowances would accrue to taxpayers that control future economic benefits that are declining in value. The test would apply without regard to legal ownership of assets or past expenditure. It would be expected, however, that in practice there would be a close correlation between past capital expenditure and the acquisition of future economic benefits that decline in value.

What should be the cost base for deductions?

Current arrangements

1.21 For some the cost base, upon which tax deductions are based, is the cost to the taxpayer, irrespective of whether the asset is new or second hand. The most notable example of this is the allowance for plant and equipment.

1.22 For other assets, most notably buildings and structures, the cost base is the original cost of creating the asset. Deduction entitlements of subsequent owners are based on the tax written-down value of the asset, not the actual price paid. Similar rules apply to expenditures on grapevines and horticultural plants.

- The original cost approach to determining deduction entitlements generally applies to assets affixed to land. It was adopted because it was simple to apply and less open to abuse through value shifting.
- The compliance benefits, if any, of such an approach are often limited, as many structures affixed to land nevertheless either constitute plant or include elements that are plant. It is necessary in those situations to apportion the purchase price between the plant and non-plant components. This issue is discussed in more detail later in this chapter.

Option: The actual cost to the taxpayer

1.23 An investor's entitlement to tax deductions should be based upon the cost of the asset to the investor. Without such an approach, asset prices and investment decisions could be distorted. Similarly, where an asset has been gifted to the taxpayer, the appropriate tax value would be the market value of the asset. This is the current treatment. While it may seem odd to allow a taxpayer deductions for expenditure that he or she did not undertake this consequence flows from the absence of taxes on gifts. To deny deductibility would be a back-door way of taxing the original gift.

1.24 A corollary of providing deductions based on the actual cost of an asset to the taxpayer would be that a balancing adjustment would be required

on the disposal of the asset. This ensures that deductions allowed to the taxpayer disposing of the asset equal the actual loss in value of the asset to the taxpayer.

Accounting principles

Accounting principles established by Australian Accounting Standard AASB 1021 'Depreciation' require depreciation only in relation to the depreciable amount of a depreciable asset. The depreciable amount is its carrying amount less the net amount expected to be recovered on its disposal at the end of its useful life.

Accounting principles established by Australian Accounting Standard AASB 1015: 'Accounting for the Acquisition of Assets' require depreciable assets to be initially valued at the cost of acquisition, being the fair value of the purchase consideration as at the date of acquisition plus costs incidental to the acquisition.

Australian Accounting Standard AASB 1010 'Accounting for the Revaluation of Non-Current Assets' allows the carrying amount of a depreciable asset to be revalued upwards or downwards to its recoverable amount.

The accounting principles approach differs from the taxation approach in that:

- all costs associated with the acquisition of an asset, including finance costs, are included in the depreciable value;
- expected disposal proceeds are not depreciated;
- it requires a regular review of depreciation rates; and
- it allows the taxpayer to revalue the asset each period.

Should the cost base be reduced by expected disposal receipts?

1.25 Under existing law the cost base for depreciation purposes assumes that the asset has a scrap value of zero. Clearly where assets are likely to have a scrap value above zero this approach will tend to overstate annual depreciation to the advantage of the taxpayer. This will be clawed back if the balancing adjustment is taxed on disposal of the asset, but the taxpayer will still have enjoyed some tax deferral. The accounting standards address this issue by denying depreciation for the estimated disposal price.

1.26 However, to implement an alternative approach would require estimates to be made of the likely scrap value of particular assets or classes of

assets. The gain in equity or efficiency is not likely to be justified by the increased compliance and administration costs in the case of most assets. However, the principle could be recognised as appropriate and applied where it was clear that some assets typically retained significant value at the end of their effective life.

Should the cost base be reduced by subsidies received?

1.27 Application of the comprehensive income tax model would suggest that a receipt of a subsidy, whether in cash or in kind, represents an increase in the net wealth of a taxpayer and should be treated as assessable income in the year of the payment. This approach would be consistent with the accounting principle and current tax law.

1.28 An alternative approach would be to reflect the subsidy or bounty in a lower cost base for the asset. Reducing the cost base would have the effect of taxing the subsidy over the write-off period for the asset — because of the lower depreciation deductions — rather than immediately. This would be a more concessional approach.

1.29 Under existing law, a bounty or subsidy received in respect of an asset is specifically treated as assessable income at the time derived. The value of the benefit is therefore reduced by the tax paid.

1.30 Where a taxpayer receives government support to acquire a business asset through import duty, stamp duty or sales tax exemptions, the cost base is lower than would have otherwise been the case. Hence, the effective subsidy is taxed over the life of the asset, rather than immediately as in the case of a direct subsidy.

When should deductions commence?

Current arrangements

1.31 Leaving aside for the moment the issue of accelerated depreciation, the object of the depreciation allowances is to provide an estimate of the actual decline in value of the asset in each year resulting from its use to produce assessable income. Where an asset has been purchased but is not being used, it is not likely to decline in value to the same extent, if at all, as an equivalent asset being used for the same period.

1.32 Under current arrangements, the various capital allowance provisions vary in relation to the year in which deductions for eligible capital expenditure can commence and the amount of deductions allowed in the initial year.

1.33 Most provisions allow deductions to commence in the year in which the asset is installed and ready for use. However, some provisions enable deductions before the investment is capable of producing income. Examples of this latter treatment include grapevines, where deductions can commence once a vineyard has been established rather than when it becomes income producing, and investment in films, where deductions are allowable even if no film has been produced in the year.

1.34 A practical issue arises where partially completed structures are used to produce income — for example, some shops or car parking spaces may be brought into income production before construction has been completed.

- One approach would be (to continue) to deny deductions until the structure is fully operational on the basis that even during the final phase of construction, there may be no (net) economic losses being incurred as a result of the (partial) usage.
- Alternatively, some attempt might be made to allocate some portion of the construction cost to the area that is being used for income production and allow depreciation in respect of that proportion.

1.35 There is also the question of the treatment of certain costs incurred during the period of construction or establishment of an asset. A range of expenditures are presently allowed as immediate deductions notwithstanding that the assets to which the expenditures relate are not yet capable of producing income. Examples of such expenditures include the following:

- Costs of tending horticultural plants prior to their becoming capable of producing commercial crops. Generally, the costs of establishing the plants are capital in nature. However, once established, the costs of tending them are generally immediately deductible from that time even though the plants are immature.
- Interest on funds borrowed for the construction of assets can be allowable during the construction phase.

1.36 Where deductions commence in the year in which the asset is first used for income producing purposes, deductions are generally available only for that part of the year the asset is in use. However, some allowances provide full year deductions even if the asset only becomes income producing on the last day of the income year — examples include: mining, quarrying and mineral transport, and intellectual property.

Accounting principles

Australian Accounting Standard AASB 1021 'Depreciation' provides that depreciation may not be allocated until the asset is first put into use or held ready for use. Making commencement of use of an asset the operational standard for when wasting assets begin to depreciate would be consistent with the accounting principle. AASB 1021 also specifies that where an asset is a complex structure made up of interdependent sub-structures requiring installation in successive stages, depreciation may not be allocated until installation has been completed to a stage where service or saleable product can be obtained.

AASB 1021 also requires that the depreciation allowed in the year of acquisition corresponds with the decline in the value of the available future economic benefit in that year.

Option 1: Write-off from time asset installed and ready for use

1.37 A consistent approach would be to allow assets to be written-off from the time when they were first installed and ready for use. This would involve allowing a part year deduction in the first year reflecting the proportion of the year for which the asset was in use.

Option 2: A standard write-off allowed in year in which asset is installed

1.38 A less consistent, but possibly simpler, approach would be to rule that all assets put into use in a particular year were entitled to a standard deduction for that year. If a full year deduction was allowed this would be generous for assets installed later in the year. Conversely a half year deduction would be generous for some assets and unduly harsh on others.

Over what period should assets be written off?

Current arrangements

1.39 At present there is little consistency in the write-off treatment accorded different assets. Some assets — typically physical assets — receive accelerated depreciation, but the degree of acceleration differs for assets of different effective lives. Other assets receive statutory write-off rates that may or may not be accelerated — for example, structural improvements and Australian films.

1.40 In the case of capital expenditure incurred on resource projects, taxpayers are required to assess whether a project will have a life of 10 years or more. If it does, eligible expenditure can be written off over 10 years. If a project is assessed to have a life of less than 10 years then eligible expenditures can be written off over that shorter life.

Option: Write-off over the effective life of the asset

1.41 Requiring assets to be written off over their effective life is likely to result in annual depreciation deductions being more closely aligned with annual declines in value of the asset than any other practical approach.

How should the period of write-off be assessed?

The statutory schedule

1.42 Prior to 1 July 1991, the law required the Commissioner of Taxation to set all plant depreciation rates. On a literal interpretation, the Commissioner was required to do this for each and every item of plant. In practice, the Commissioner published a schedule of rates (Income Tax Order 1217) for a range of asset classes which taxpayers could adopt. Effective lives implicit in the rates published by the Commissioner represented an estimate of the average circumstances of use. Taxpayers were able to obtain special rates based on their particular circumstances of use.

1.43 Since 1 July 1991, taxpayers have had the option either of making their own estimate of the effective life of an item of plant, as defined, or of adopting the effective life published by the Commissioner in the depreciation schedule (Taxation Ruling IT 2685). The integrity of the schedule has been compromised because it has not been systematically updated.

1.44 The definition of effective life allows taxpayers to take into account their own particular circumstances of use. The law does not prescribe how taxpayers are to work out effective life. It is something to be determined

objectively according to the facts. Factors that would be relevant to the process would include manufacturers' specifications, engineering studies and past experience with similar assets. If taxpayers are found not to have assessed effective lives objectively, the Commissioner can substitute his own estimates.

1.45 Many taxpayers find it easier to use the Commissioner's effective life schedule. Taxpayers are concerned that the schedule is not representative of many classes of assets. For example, the effective life of 5 years for computers is criticised as being too long for some types. On the other hand, the Commissioner's effective life of some assets could be considered to be too short — for example, 8 years for general aircraft (4 years for crop-dusters), 5 years for mainframe computers and 20 years for power stations.

1.46 The Commissioner of Taxation has advised the Review that, as a matter of good administration, the ATO will progressively update and expand the effective life schedule to ensure that the schedule is as representative as possible. An updated schedule will provide taxpayers with information on assets to assist them in determining effective lives for taxation depreciation purposes.

1.47 A priority for the Commissioner is to adjust those effective lives in his schedule where there are clear anomalies. The Review has been informed that this initial process will be completed as expeditiously as possible. A complete revision, however, will take some time to complete.

Option 1: Self-assessment

1.48 Option 1 would retain the existing system which enables taxpayers to self-assess, or to select an appropriate effective life from the Commissioner's schedule.

Option 2: Use effective life schedule with option for variation

1.49 Option 2 would require taxpayers to select the appropriate effective life from the Commissioner's schedule, while retaining the option for taxpayers to seek a variation in particular cases.

1.50 Option 1 has the advantage that it would enable taxpayers to retain maximum flexibility in determining effective lives and it would minimise compliance costs. On the other hand, it would be unrealistic to expect that the average effective lives applied under this system would be as long as those resulting from Option 2. Taxpayers will tend to choose the shortest plausible effective life and the realities of tax administration are that the Commissioner is only likely to challenge the bolder claims.

1.51 Option 2 would provide taxpayers with certainty and predictability, while also providing opportunities for taxpayers to seek variations where

appropriate. An updated and expanded effective life schedule would provide taxpayers with an appropriate basis to determine their rates of taxation depreciation. The need for taxpayers to explicitly seek variations from the effective life schedule means that Option 2 would be less flexible for those taxpayers needing to seek variations.

1.52 Neither option would allow a taxpayer to depreciate its assets in accordance with AASB 1021 'Depreciation'. Adopting the accounting standard would allow taxpayers to reassess the effective life and the value of assets from time to time. While such an approach would move tax depreciation closer to accruals, it would not provide a workable basis for the operation of the tax law because of the tax planning opportunities it would create. Moreover, it could mean that upward revaluations of assets would become a taxing event which could provide cash flow problems for some taxpayers.

Should buildings and structures receive special treatment?

1.53 The present treatment allows depreciation based on the original cost of the building or structure while any capital gain on the combined land and building or structure package is taxed on realisation. This treatment means that on the sale of a land and building package if the value of the building is greater than its depreciated value this amount is not clawed back. (A prospective change to address this problem to some extent is before Parliament and described in Appendix C.) To this extent the seller is under-taxed but the purchaser cannot claim a deduction to the extent of that under-taxation and so the possibility of double deductions is avoided.

1.54 In cases where the land and building package appreciates in value, allowing the depreciation of the building exacerbates the tax deferral inherent in the current capital gains treatment.

Option 1: Retain existing treatment

1.55 Option 1 would retain the existing treatment which taxes the value of the land and building or structure package upon realisation but provides annual taxation write-off for the building or structure on the basis of original cost.

Option 2: Include buildings and structure in a consistent regime

1.56 Option 2 would recognise the fact that ultimately buildings do depreciate and incorporate buildings and structures into the general

depreciation regime. This would require the separate valuation of land and buildings at the time of sale. This is consistent with the accounting treatment set out below.

1.57 Under Option 2, buildings and structures would be brought into the depreciation regime applying to all physical assets. This would imply that buildings and structures would receive taxation depreciation in line with their effective lives and full balancing adjustments would apply. It would also mean that property investors would benefit from depreciation allowances based on the full purchase price — rather than a fixed allowance based on the construction cost.

1.58 However, this approach would require the separate valuation of buildings or structures and the land they were situated upon. The treatment of the two assets for tax purposes would be markedly different, with buildings or structures depreciated on an annual basis and the land subject to capital gains tax only on a realisations basis. In some cases separate valuation is already required under the current tax system.

1.59 This approach would not be compatible with allowing indexation in respect of capital gains. This is because it would imply not taxing the seller on the indexation component of any capital gain on the asset but allowing the purchaser to depreciate from the full purchase price including the indexation component. Consequently, over the life of the building the total deductions allowed would exceed the original cost of the building. This is theoretically possible under the current arrangements for depreciation of plant and equipment but does not arise in many cases as capital gains are rarely realised on plant and equipment.

Option 3: Reduce the rate of depreciation

1.60 Option 3 would reduce the tax deferral involved in current arrangements by applying a lower rate of depreciation (including possibly a zero rate) to buildings and structures than might be implied by their underlying effective life.

International treatment

1.61 *An International Perspective* (pages 74 to 76) summarises the taxation treatment of buildings in selected countries. It shows that the majority of countries, including the United States, allow deductions based on actual cost to the taxpayer. The remainder, including the United Kingdom, allows deductions based on original cost.

If the treatment of buildings and structures were to change, what transitional measures should apply?

1.62 If buildings and structures were to be brought into the generalised depreciation arrangements, transitional arrangements would be important. Two options are suggested for addressing this issue.

Option 1: Apply only to new buildings and structures

1.63 Option 1 would apply the new arrangements to new buildings and structures for which construction contracts have been entered into after the date the new measures are to take effect.

1.64 Option 1 would mean that existing arrangements would continue to apply to all existing buildings and structures. That is, some items would continue to be ineligible for tax deduction; others would continue to receive deductions based on their construction costs until such time as the deductions are exhausted, after which time no further deductions would be available. This option would mean that taxation considerations could distort investment decisions or market prices.

Option 2: Apply to buildings and structures acquired after the new measures take effect

1.65 Option 2 would apply to all buildings and structures that are acquired after the date the new measures are to take effect.

1.66 Option 2 would accord more closely with transitional arrangements as they have applied to past changes in tax depreciation rates. This option would require vendors of existing buildings to be subject to full balancing adjustments, up to the value of depreciation deductions allowed to them in respect of the building, upon disposal.

Accounting principles

AASB 1021 'Depreciation' requires that the carrying amount for freehold land and buildings must be apportioned between the land and building component, with each component being separately depreciated. Accordingly, the building component might attract depreciation, while generally the land component would not.

This accounting treatment would provide a basis for a more appropriate depreciation regime for buildings if the accounting valuations were robust enough for tax purposes.

Should special rules apply to the resources sector?

1.67 Several issues specific to the mining and quarrying industries are as follows:

- While exploration and prospecting expenditure is deductible, receipts from the sale of the results of that expenditure are often not taxable.
- Capital expenditure on project development and operations is presently deductible over the lesser of the life of the project or 10 years (20 years in the case of quarrying). This represents a significant acceleration of deductions for long-life projects.
- Special rules in the nature of a loss carry-forward mechanism allow losses incurred by resources companies to be transferred to other taxpayers with virtually no restrictions.

1.68 More information on these issues is contained in Appendix D.

1.69 Under a standardised model for the treatment of capital allowances, no special rules would apply to the resource sector. However, the Review notes from the comparative effective tax rate tables in Chapter 7 of *An International Perspective* that the resources sector is favourably taxed in all of the jurisdictions surveyed.

Should there be immediate write-off for small items?

1.70 Immediate deductions are allowable for items of plant that cost \$300 or less, irrespective of the effective life of the items. A similar, though more limited form of immediate write-off, is proposed for expenditure on computer software (in this case, immediate write-off would not apply to multiple purchases of the same or similar software). As well the Review notes that the Commissioner of Taxation currently allows a higher limit of \$500 in some cases.

1.71 A rationale for the immediate write-off for low cost items is that it obviates the need for taxpayers to make annual calculations of depreciation entitlements for such items.

1.72 The immediate write-off discriminates between various classes of taxpayers as it favours those who, by the nature of their businesses, tend to invest in many small items over those who invest in high-cost items.

1.73 The existing provision also provides scope for tax minimisation where the value of depreciable assets originally costing more than \$300 has subsequently fallen to \$300 or less. In a typical arrangement, a taxpayer in that situation can sell the items to another entity, usually a financier, who then

leases them back. The financier is able to claim an immediate deduction for the cost of the items whereas the taxpayer would have been obliged to continue to write the assets off had the taxpayer retained them.

Option 1: Limit number of items to be written-off

1.74 Option 1 would limit deductions to a specified number of items of the same class (for example, 30) each costing less than the *de minimis* threshold.

1.75 A *de minimis* limit can be justified in terms of reducing taxpayer compliance costs, particularly where the taxpayer writes off all *de minimis* items for accounting purposes, but any measure needs to be struck at a level that neither compromises the integrity of the law nor provides significant unfair advantages to particular taxpayers.

1.76 A difficulty with Option 1 would be identifying whether items were the same. For example, would two gas bottles of slightly different capacities be of the same class?

Option 2: Limit total deduction available

1.77 Option 2 would place an annual dollar limit (say, \$10,000) for immediate write-off on the aggregate of purchases of items each costing less than the *de minimis* threshold.

1.78 Option 2 would overcome the problem of specifying classes or assets within them. It would minimise record keeping and other compliance costs for small business.

Items with low written down values

1.79 An issue arises where the depreciable value of assets falls to a minimal value. Under the diminishing value approach taxpayers have to continue depreciating assets until disposed of or scrapped. If there was a rule which allowed assets with a written down value below a certain level (say \$100 or 4 per cent of original cost) to be written off in the year that the value falls below that level this would reduce compliance costs.

Accounting principles

Under the principle found in Australian Accounting Standard AASB 1031 'Materiality', depreciation applies only where it is material, which will vary according to the taxpayer's circumstances. Materiality would therefore need to be considered in determining whether assets are depreciated or immediately written off for accounting purposes.

What write-off method should apply?

1.80 For plant and equipment, taxpayers may currently depreciate particular assets on either the prime cost (straight-line) or diminishing value methods. Once an election is made, it is irrevocable. The other capital allowances use the prime cost method only.

1.81 The choice between the diminishing value or prime costs methods should depend on which is more likely to match the actual pattern of decline in the value of the asset. For many physical assets the diminishing value method may better approximate changing value because it provides a more rapid rate of decline in early years. The diminishing value method also offers compliance benefits where assets are modified or improved — because the cost of those improvements can simply be added to the asset's tax value.

1.82 For those who intend to hold assets for a long time, a perceived disadvantage of the diminishing value method is that it will remain on the books until disposed of. The option to allow immediate write-off for low value assets would address this problem.

1.83 The diminishing value method if universally adopted would simplify the taxation of second-hand assets. This is because the amount of the deduction in any year is a function of the asset's value for depreciation purposes at the beginning of the year and the rate of depreciation as determined by the asset's effective life when new.

1.84 A problem arises where the prime cost method is used. Under prime cost, a taxpayer is required to assume that the plant is new and calculate the amount of depreciation accordingly. For example, where an asset has a 10 year effective life and a taxpayer buys it secondhand after 8 years the purchase price has to be depreciated as if the asset is going to be in use for another 10 years. Consequently the rate of depreciation can be significantly less than that which might be appropriate. In contrast, under the diminishing value method the asset would be depreciated at 15 per cent a year on the basis of its original cost to the new taxpayer.

1.85 This problem with prime cost could be addressed if vendors of second hand assets passed on to purchasers information on the age of the asset. In that case a person buying an 8 year old asset in the example above could depreciate the purchase cost over the next two years.

Accounting principles

AASB 1021 'Depreciation' requires the allocation of the depreciable amount of an asset on a systematic basis over the useful life of the asset. The allocation must reflect the pattern in which the asset's future economic benefits are consumed or lost. Accordingly, restricting the selection of depreciation methods, for some assets, would involve a departure from accounting principle. AASB 1021 requires that the choice between prime cost, diminishing value and other methods of allocating depreciation be made having regard to the underlying facts.

How should assets be taxed upon disposal?

Current arrangements

1.86 Neither accounting practice nor the taxation system can precisely replicate the economic rate of appreciation or depreciation. A balancing adjustment is needed to ensure that only the change in the economic value over the period an asset is used is allowable as a tax deduction. By allowing the revaluation of assets, and consequential adjustments to depreciation, accounting practice seeks to minimise these adjustments on disposal.

1.87 When the asset is disposed of, the depreciation balancing adjustment allows a deduction if the tax deductions are less than the actual decline in value and taxes excess deductions. However, taxpayers can defer tax on balancing charges by electing for balancing charge offset.

1.88 The offset allows taxpayers to set otherwise assessable balancing charges successively against the cost of replacement assets, the cost of other new assets or the depreciated value of other assets. Balancing charge offset was enacted to facilitate acquisition of replacement equipment by taxpayers. It has a benefit to taxpayers who have had the benefit through excess deductions of a further deferral of tax. Balancing charge offset, however, does not apply uniformly to all classes of assets — it only applies to plant and equipment.

1.89 The current treatment of disposals of wasting assets can be complex to comply with because some disposals can be subject to both the capital allowance and CGT provisions of the law. This means that even though an asset may have wasting characteristics, records must be maintained on the chance that it may be disposed of for a consideration in excess of its original cost base. If indexation was no longer available under CGT and balancing adjustments were recognised on disposal then capital gains and positive

balancing adjustments would be taxed consistently with a consequent reduction in record keeping requirements.

1.90 The availability of balancing charge offset would be of more assistance to some taxpayers than others. Taxpayers with assets where the depreciation allowances are significantly accelerated and where there is an active secondhand market in assets can obtain significant benefit from the further tax deferral. On the other hand taxpayers with assets where there is little acceleration of depreciation or no effective secondhand markets would not benefit.

Option: Remove balancing charge offset

1.91 Removal of the offset would produce revenue gains that might help fund alternative measures such as reductions in the corporate rate. Such a trade-off would be at the expense of those taxpayers who currently derive significant benefit from the offset but it would benefit other taxpayers.

1.92 Removal of the balancing charge offset provisions would result in the cost of an asset being fully deducted over the effective life of the asset. The current arrangements allow deductions in excess of the cost of the asset.

How should conversion of use of depreciable assets be treated?

Current arrangements

1.93 Under the current law, generally, no adjustment is required when taxpayers convert the use of depreciable assets from assessable income producing use to other uses, including private use. By comparison, there are rules governing the reverse situation, where the use of private assets changes to assessable income producing use. In that instance, deductions are generally based on the notional written down value of the asset.

1.94 The current treatment of changes in the use of depreciable assets is inconsistent with the approach of moving tax values closer to commercial values. There have been instances where the current treatment has provided tax minimisation opportunities, including cases where tax deductions on mobile assets have been claimed and then moved offshore without balancing adjustments being required.

Option: Treat the conversion as an acquisition or disposal at market value

1.95 From the viewpoint of neutrality and equity, where an asset is converted from a business use to a non-business use this should be treated as a

disposal at market value for tax purposes. (This may result in the taxpayer being liable for tax in respect of a positive balancing adjustment when there has been no realisation.) Similarly, where an asset is converted from a non-business use to a business use there are reasons why this should be treated as an acquisition at market value.

How should blackhole expenditures be treated?

Option: In a manner consistent with other expenditures

1.96 The term *blackhole expenditures* refers to the range of expenditures undertaken for the purposes of earning assessable income that currently do not qualify either for deduction or for write-off but which should so qualify either because they produce no enduring benefit or the benefit will endure for a fixed period. The cost of closing a business is an example of the former and a lease premium is an example of the latter.

1.97 In some cases, such as feasibility studies, it is not evident at the time whether or not the expenditure will produce an asset. If the study was subsequently abandoned, there would be no asset. By comparison where the project proceeds, the cost of the feasibility study should be included in the cost base of the project — a new shopping mall, for example.

1.98 Such expenditures would qualify for deduction or effective life write-off. Thus business closure costs would be deductible at the time incurred, unsuccessful feasibility studies would be deductible at the time that the study was abandoned, and the costs of successful feasibility studies would be treated in the same way as the asset(s) to which they relate.

1.99 A range of expenditures produce benefits with an indeterminate life. Examples include pre-incorporation expenses and some prospectus and underwriting costs. The benefits of those sorts of expenditures endure for the life of the entity. The argument for providing write-offs for such expenditures is that, while their value over time cannot be predicted, the time may come when they have no value, for example, when the entity is wound up. A practical approach to this problem might be to allow write-off of such expenditures over an appropriately long period, say, for example, 10 years. If circumstances arose when they had no value prior to the end of that statutory period they could be written off at that time.

1.100 Table 1.1 summarises the possible treatment of selected *blackhole* expenditures.

Table 1.1: Expenditures to be considered under possible ‘blackhole’ treatment

Expenditure	Possible treatment
Unsuccessful feasibility or market studies	Deductible at time of abandonment
Successful feasibility or market studies	Added to the cost of asset(s). Treatment would depend on treatment of asset. Statutory write-off might be appropriate if not attributable to a specific asset.
Export market development expenses	Deductible at time incurred or written-off over a statutory period
Winding up and closure costs	Deductible at time incurred
Mine closure costs that do not relate to site rehabilitation	Deductible at time incurred
Demolition costs	Included in the cost of the land
Relocation costs	Deductible at time incurred
Contribution to local or regional infrastructure as condition of project	Added to cost of asset where relevant. Otherwise write off over a statutory period.
Expenditure to preserve title to an asset	Deductible at time incurred
Payment to defend native title claims	Deductible at time incurred
Company pre-incorporation costs; legal and consulting fees to establish a business	Write-off over statutory period of time
Prospectus and underwriting costs	Write-off over statutory period of time
Takeover defence costs	Write-off over statutory period of time
Landscaping	Generally no deduction or write-off

1.101 Demolition costs could be treated as part of the cost of constructing a new building and so be subject to depreciation on that basis. Alternatively they could be added to the cost base of the land for capital gains tax purposes and so would be effectively deductible at the time the land was sold. The second approach is simpler as it would not require the tax law to differentiate between when a taxpayer demolished a building and structure and then sold the land, and when he or she demolished the building or structure and replaced it with a new one.

1.102 Landscaping expenditure is an example of where an asset is created which is likely to be maintained in value by expenditures over time which will be immediately deductible to the taxpayer. In such circumstances it would seem inappropriate to write off the original expenditure. Instead it would be reflected in the cost base of the land and effectively deducted against capital gains tax at the time of sale.

1.103 For some expenses, such as winding up and closure costs, particular issues arise because tax deductions may be worthless in the case of stand-alone companies. In such cases, there is an argument for a limited form of loss carry back to ensure an appropriate recognition against income.

1.104 Not considered above is ‘goodwill’, which, because of its unique characteristics, is discussed separately in Chapter 4.

Accounting principles

The proposed treatment of *blackhole* expenditures would be broadly consistent with accounting principles. The accounting principles in Statement of Accounting Concepts SAC 4, ‘Definition and Recognition of the Elements of Financial Statements’, require expenditure that does not make a future economic benefit available to the taxpayer or satisfy the recognition criteria to be immediately written-off. Other expenditure would be subject to capital allowance treatment if:

- it made a future economic benefit available to the taxpayer; and
- the future economic benefit had a limited useful life.

AASB 1021 ‘Depreciation’ requires that the depreciable amount be allocated on a systematic basis over the useful life of the asset in a pattern that reflects the consumption of the future economic benefits embodied in the asset.

Current capital allowance provisions

Table A.1: Summary of existing tax treatment of selected wasting assets

Provision	Who may deduct?	Over how long?	Treatment upon disposal
Plant and equipment	Owners and holders of interests in land granted by the Crown	Accelerated from effective life commencing when plant is first used for producing income or is installed ready for use	Balancing adjustment required. Balancing charge offset available. CGT may be payable
Capital works: buildings, structural improvements, earthworks and extensions, alterations and improvements	Owners, lessees and holders of interests in land granted by the Crown	25 years where used either as short-term traveler accommodation or in eligible industrial activities; otherwise 40 years	Balancing adjustments not required ^(a) . Deduction allowed if destroyed before cost fully written-off. CGT may be payable
Development allowance	Owners and lessees	Immediate 10 per cent write-off when unit of eligible property is first used for producing income or is installed ready for use	Deduction disallowed if property disposed of within 12 months
Drought investment allowance	Owners and lessees	Immediate 10 per cent write-off when unit of property is first used for producing income or is installed ready for use	Deduction disallowed if property disposed of within 12 months
Electricity connections	Any entity with an interest in land	10 years	na
Environmental impact studies	Any entity with an income producing project	Lesser of 10 years or life of project	na
Environment protection	Any entity	Immediate	na
Films	Any entity except partnership	Immediate	Assessable
Grapevines	Primary production entity	4 years	Deduction if vines destroyed before cost fully written-off CGT may be payable
Horticultural plants	Entity carrying on horticultural business	Accelerated from effective life	Deduction if plants destroyed before cost fully written-off CGT may be payable

Table A.1: Summary of existing tax treatment of selected wasting assets (cont)

Provision	Who may deduct?	Over how long?	Upon disposal
Industrial property	Any entity	Effective life as determined by relevant statute	Balancing adjustment required CGT may be payable
Landcare operations	Primary production business, or business on rural land, except mining or quarrying	Immediate	na
Mining or quarrying: exploration or prospecting	Exploration or prospecting entity	Immediate	Balancing adjustment required CGT may be payable
Mining or quarrying: development or operation	Development or operation entity	Mining: lesser of 10 years or life of mine. Quarrying: lesser of 20 years or life of quarry.	Balancing adjustment required CGT may be payable
Mining or quarrying: transporting minerals or quarry materials	Development or operation entity or transport entity	Minerals: 10 years Quarry materials: 20 years	Balancing adjustment required CGT may be payable
Mining or quarrying: site rehabilitation	Development or operation entity	Immediate	na
R&D	Australian companies engaged in R&D	Various write-off provisions depending on item of expenditure	Balancing adjustment required for disposal of item of plant
Telephone lines	Any entity with an interest in land	10 years	na
Timber mill buildings	Entity carrying on timber milling operations	Lesser of 25 years or estimated life of building	Balancing adjustment required. CGT may be payable
Timber operations: forestry roads	Entity carrying on timber operations	Lesser of 25 years or estimated life of road	Balancing adjustment required CGT may be payable
Water conservation	Entity carrying on primary production operations	3 years	na

(a) Proposed amendments to the CGT cost base rules will claw-back deductions allowed where disposal proceeds exceed tax written down value.

Plant and equipment

Current arrangements

B.1 The taxation write-off for plant and equipment is accelerated from effective life. Similar arrangements apply to horticultural plantations. The existing accelerated schedule, introduced in 1992, is set out in Table B.1. The write-offs are based on the cost of acquiring an asset and write-offs can commence in the year in which assets are installed ready for use or become income producing.

Table B.1: Taxation depreciation by broadband

Effective life years	Taxation write-off years	Prime cost %	Diminishing value %
Less than 3	1 ^(a)	100	100
3 to fewer than 5	2.5	40	60
5 to fewer than 6 2/3	3.7	27	40
6 2/3 to fewer than 10	5	20	30
10 to fewer than 13	5.9	17	25
13 to fewer than 30	7.7	13	20
30 or more	14.3	7	10

(a) Property costing not more than \$300 can also be written off in the year of acquisition.

B.2 The following figure illustrates the existing taxation write-off system for plant according to effective lives measured in years. It compares effective life write-offs for assets with effective lives up to 50 years — note that the taxation depreciation remains constant thereafter irrespective of the asset's life. For simplicity, the chart assumes that assets with an effective life at the bottom of each range receive the write-off applicable at the top of the preceding range.

Figure B.1: Depreciation for assets with effective lives up to 50 years

B.3 Figure B.1 illustrates that the longer an asset's effective life, the greater the rate of accelerated write-off — the difference between the two lines. It also shows that because of the broadbanding, the rate of acceleration for assets with effective lives of less than 13 years is lumpy, with assets at the lower end of the broadbanding being relatively disadvantaged compared with assets at the upper end of the band. This inequality of treatment is illustrated in Table B.2.

Table B.2: Effective depreciation loadings within bands

Years effective life	Percentage loading beginning of range	Percentage loading end of range
1 to fewer than 3	0	300
3 to fewer than 5	20	100
5 to fewer than 6 2/3	35	80
6 2/3 to fewer than 10	34	100
10 to fewer than 13	70	120
13 to fewer than 30	70	290
30 or more	110	na

B.4 For items with an effective life of 30 years the loading is 110 per cent. (The loading represents the rate of acceleration over an effective life write-off.) The loadings then progressively increase — for example, assets with effective lives of 40, 50 and 60 years, have respective loadings of 180, 250 and 320 per cent.

B.5 As noted in the body of the chapter, the depreciation arrangements for plant and equipment enable taxpayers to defer the balancing charge on

disposal. Thus, unlike investors in other types of business assets, investors in plant and equipment enjoy not only the tax deferral benefits conferred through accelerated depreciation, they can also defer the recoupment of these benefits by electing for balancing charge offset. This allows taxpayers to set otherwise assessable balancing charges successively against the depreciable value of other assets. The deferred balancing charge is then clawed back by the fact that deductions for the replacement asset are reduced by the amount of the deferred gain. However, where an asset is replaced repeatedly and the balancing charge rolled over every time the period of deferral can be very long.

Buildings and structures

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Current arrangements

C.1 Buildings and other structures (including structural improvements) are eligible for annual deductions of either 2½ or 4 per cent based on the construction cost of the asset. The annual rate of write-off is fixed and once an asset is written off, no further deductions are available. Improvements to the original property become separate assets for depreciation purposes.

C.2 Buildings and structures are subject to a different balancing adjustment regime to plant and equipment. Broadly, under the draft law currently before the Parliament, taxpayers disposing of buildings and structures would be brought to tax on the gain or loss depending on whether the disposal price is above or below the property's reduced cost base. The reduced cost base is the original cost base reduced by the capital allowances claimed to the time of disposal. The taxpayer buying the property would, however, only be entitled to a continuation of the existing write-off arrangements. This measure reduces the degree of tax deferral available from current taxation arrangements.

Example C.1: Proposal currently before Parliament

A taxpayer constructed a building costing \$1 million. After 10 years, building allowances of \$250,000 had been claimed, resulting in a reduced cost base of \$750,000. The indexed cost base is \$850,000 (indexation is calculated by reference to the reduced cost base).

- If the building was sold for \$1.2 million, the vendor would derive a capital gain of \$350,000 (\$1.2 million less \$850,000 indexed cost base).
- If the building was sold for \$700,000, the vendor would be allowed a capital loss of \$50,000 (\$700,000 less \$750,000 reduced cost base).
- If the building was sold for \$800,000, there would be no capital gain or capital loss (because the disposal proceeds are between the indexed cost base and the reduced cost base).

In all cases, the purchaser would be entitled to an annual depreciation allowance of \$25,000 a year for 30 years (\$750,000 in total), irrespective of the price paid for the property.

C.3 Taxation amortisation for buildings was only introduced in the late 1970's for the first time and structures were not generally brought into the regime until 1992.

What is the problem?

- C.4 There is a range of problems with the existing arrangements.
- Apart from short term traveller accommodation and industrial buildings which can be written off over 25 years, all other buildings and structures are written off over 40 years. No regard is had to the economic or effective life of the structure. For example, a wooden building receives the same taxation write-off as one constructed from sandstone. The former might receive less than effective life write-off, while the latter most likely receives accelerated depreciation.
 - Even for hotels and the like and industrial buildings, their effective lives might have more to do with the quality and type of construction, their usage patterns or their location (which could influence the rate of deterioration), rather than that they are hotels or factories.
 - The demarcation between an industrial building and an item of plant can sometimes be arbitrary. For example, a factory can under some circumstances be plant (and can therefore enjoy

accelerated depreciation). Some argue that an airport runway — which is a structure for tax law purposes — has characteristics of plant.

- The balancing charge arrangements are neither consistent with those available for plant and equipment nor do they provide an appropriate outcome for purchasers of second-hand property.
- Record keeping and compliance are complicated because where taxpayers undertake improvements to existing structures, such improvements can not be added to the cost base of the underlying asset for tax purposes. Rather, they have to be written off as if a separate asset.

C.5 At the moment no deductions are available for parts of buildings or structures brought into use until the whole building or structure is brought into use.

Mining and resources

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Current arrangements

Exploration and prospecting

D.1 Expenditure on exploration or prospecting for minerals (including petroleum) and quarry materials is generally immediately deductible at the time incurred, irrespective of whether the expenditure is revenue or capital in nature. Exploration and prospecting includes studies to evaluate the economic feasibility of extracting the minerals or quarry materials.

Project development and operation

D.2 Expenditure on plant and equipment is treated in the same way as for other taxpayers generally. That is, expenditure is written-off at accelerated rates applicable to the effective life of the asset.

D.3 Other capital expenditure on developing and operating a mining or quarrying project (allowable capital expenditure) is generally evenly deductible over the lesser of the life of the project or 10 years (20 years in the case of quarrying). Broadly, allowable capital expenditure includes expenditure on site development (such as land clearing and mining shafts), access roads, buildings and the provision or contribution to facilities such as water, light or power. Also included are expenditure on housing and welfare facilities used in carrying on mining (but not quarrying) operations and successful cash bid payments for the grant of an authority to mine or to explore or prospect for minerals (including petroleum).

D.4 Allowable capital expenditure also includes expenditure on acquiring mining, quarrying or prospecting rights and information to the extent of amounts agreed to by the vendor and the purchaser of the right or information. The agreed amount cannot exceed the actual purchase price. Nor can it exceed the sum of:

- the vendor's allowable capital expenditure deductions entitlements in respect of the right or information;
- the vendor's exploration and prospecting deduction entitlements (which do not have to be in respect of the right or information);
 - this recognises that mining taxpayers often incur significant amounts on unsuccessful exploration and prospecting activities and allows them to attach the expenditure to successful activities; and
- any amount that the vendor is assessable to as a balancing adjustment in respect of the transfer of the right or information.

D.5 The purpose of the agreements is to allow for the transfer of deduction entitlements between vendor and purchaser, subject to the condition that the maximum amount that can be transferred can not exceed the amount of expenditure incurred by the vendor. A purchaser cannot obtain deductions for any excess purchase price. (A similar rule applied under the plant depreciation rules prior to 1997.) Similar provisions apply to the transfer of cash bidding amounts.

Excess deductions

D.6 Unless an election is made, deductions for exploration and prospecting expenditure and allowable capital expenditure are limited to the amount of available income. The excess deductions are carried forward for deduction in the following year, subject to there being sufficient income in that year to absorb deductions. Excess deductions can be carried forward indefinitely until fully absorbed.

D.7 If an election is made, the limits do not apply, and any resultant losses are available for transfer under the company group loss transfer provisions.

D.8 The excess deduction rules are, in effect, a loss carry-forward mechanism, separate from the general provisions for company and trust losses. They were enacted before the 1990 removal of the 7 year limit on the carry forward of non-primary production losses to recognise that the mining sector might not be able to fully use early year losses within 7 years.

D.9 As well, the excess deduction rules facilitate agreements for the transfer of deduction entitlements from vendors to purchasers of mining,

quarrying or prospecting rights and information. As described above, a vendor of such assets can agree to attach undeducted unsuccessful exploration and prospecting expenditure to assets being disposed of.

Site rehabilitation expenditure

D.10 Expenditure (whether revenue or capital) on restoring the site of mining or quarrying operations is deductible at the time incurred. Expenditure on plant and buildings used in such activities is eligible for write-off under the provisions for plant and buildings respectively. Australian Accounting Standard 1022 'Accounting for the Extractive Industries' allows the establishment of a provision for restoration work at the time of undertaking the activity requiring restoration.

Transport of minerals and quarry materials

D.11 Expenditure on infrastructure for transporting minerals and quarry materials away from the site of mining or quarrying operations is evenly deductible over 10 years (20 years in the case of quarrying), irrespective of the effective life of the property. Facilities eligible for write-off include railways, roads, pipelines and certain port facilities. Also eligible for write-off are payments to landholders as compensation or for construction rights, and contributions to someone else's eligible facilities and to publicly owned railway rolling stock.

Balancing adjustments

D.12 Balancing adjustments are required if property is disposed of, lost or destroyed, or it otherwise ceases to be used for the purposes for which deductions are allowable.

What is the problem?

D.13 The current treatment of expenditure on, and income from exploitation of minerals, exploration and prospecting can be asymmetrical. While exploration and prospecting expenditure is generally immediately deductible, receipts from sale of the results of such expenditure (that is, mining/quarrying information) are often not taxable.

D.14 The treatment of capital expenditure on development and operations is inconsistent and distortionary:

- There is a significant acceleration of deductions for long-life projects. On the other hand, some expenditures can have an

effective life less than 10 (or 20 years in the case of quarrying) and the life of the project and yet have to be written off over the longer period. For example, a shaft driven solely to access a small body of ore that is to be mined over a shorter period of time than the main ore-body.

- There is a range of expenditures that presently do not qualify for write-off, including costs of acquiring mining or prospecting rights and information from governments, contributions to regional infrastructure as a precondition to commencing operations and demolition costs.

D.15 The rules about excess deductions are open to exploitation.

- Unlike the company and trust loss provisions, there are no safeguarding measures in relation to continuity of ownership and income injection. This allows trafficking in excess deductions of the type that the company and trust loss provisions seek to prevent for losses generally.

1.105 The purpose of the excess deduction rules largely disappeared following the repeal of the former limit on the carry forward of non-primary production losses. It would completely disappear if purchasers of mining rights and information were to be entitled to write-off the full purchase price.