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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA
HOUSE OF REPRESENTATIVES

INCOME TAX ASSESSMENT AMENDMENT BILL (NO. 3) 1980

EXPLANATORY MEMORANDUM

(Circulated by authority of the Treasurer,
the Hon. John Howard, M.P.)

Introductory note

This Bill will give effect to the Government's decision to amend the income tax law to provide immediate deductibility for capital expenditure incurred by a taxpayer carrying on a business of primary production on land in Australia, on the acquisition, construction or installation of plant or a structural improvement, or of an extension thereto, for the purpose of conserving or conveying water for use in that business.

Under the present law, expenditure of this kind is deductible either by way of depreciation over the life of the plant or, in the case of expenditure on an item that does not qualify as plant for depreciation purposes, by equal instalments over 10 years.

The proposed amendments will permit such expenditure to qualify for immediate deductibility if it is incurred on or after 14 April 1980 under a contract entered into on or after that date or where construction or installation by the taxpayer commences on or after that date.

There are to be appropriate safeguards against abuse of the deduction and specific provision is made for a reduction in the amount otherwise deductible where a taxpayer receives a total or partial recoupment of his or her expenditure.

A more detailed explanation of the clauses of the Bill is contained in the following notes.

Clause 1 : Short title, etc.

By this clause the amending Act is to be cited as the Income Tax Assessment Amendment Act (No. 3) 1980, and the clause also identifies the Income Tax Assessment Act 1936 that is to be amended as the "Principal Act".

Clause 2 : Commencement

Under this clause the amending Act is to come into operation on the day it receives the Royal Assent. But for this clause, the amending Act would, by reason of section 5(1A) of the Acts Interpretation Act 1901, come into operation on the twenty-eighth day after the date of Assent. The new deduction proposed by the Bill will apply in the current income year and early commencement will facilitate the preparation of income tax returns and the raising of assessments in respect of the 1979-80 income year.

Clause 3 : Depreciation

This clause proposes an amendment to section 54 of the Principal Act that is consequential upon the proposed insertion by clause 5 of new section 75B that will provide for the new right of immediate deductibility.

Section 54 authorises deductions for depreciation in respect of plant used in producing assessable income. The section defines "plant" as including certain structural improvements on land used for the purposes of agricultural or pastoral pursuits where the cost of those items does not qualify for deduction under other specified sections of the Principal Act.

The cost of plant and improvements that will qualify for immediate deductibility under the proposed section 75B is to be similarly excluded from the operation of section 54.

Sub-clause (1) will insert two new sub-sections - sub-sections (5) and (6) - in section 54.

Sub-section (5) is designed, subject to sub-section (6), to preclude the allowance of a deduction for depreciation of a unit of property where expenditure incurred in respect of that property has been allowed, or, but for the expenditure having been recouped, would have been allowed, as a deduction to any person in any year of income under the provisions of the new section 75B.

This will mean that where a taxpayer is allowed a deduction under proposed section 75B, in respect of expenditure incurred on the acquisition, construction or installation of a unit of property, or of an extension thereto, depreciation allowances will not be available in respect of that unit or

extension to the taxpayer or to a subsequent purchaser of the unit or extension. The proposed denial of depreciation to a subsequent purchaser of an item that has qualified for immediate deductibility in the hands of the vendor recognises that the vendor is not to be subject to any balancing adjustment on disposal of such a unit.

Sub-section (6) will, by rendering the provisions of sub-section (5) inoperative to the necessary extent, permit deductions by way of depreciation in respect of so much of the expenditure incurred by a taxpayer in respect of a unit of property as is not deductible under section 75B for a reason other than that the expenditure has been recouped. This situation could arise where a taxpayer acquires an item of eligible plant before 14 April 1980 but does not commence to instal it until after that date.

In such a case, expenditure incurred on the installation of the plant will qualify for immediate deductibility under section 75B while expenditure incurred on the acquisition of the plant will qualify for depreciation under section 54.

By sub-clause (2), the amendment proposed by sub-clause (1) is to apply to assessments in respect of income of the year of income in which 14 April 1980 (date of announcement of the immediate deduction) occurs, and subsequent years of income.

Clause 4 : Deduction of certain expenditure
on land used for primary production

This clause proposes amendments to section 75A of the Principal Act that are consequential on the proposed insertion of the new section 75B by clause 5.

Under section 75A of the Principal Act special deductions, by way of equal annual instalments over 10 years, are available for certain capital expenditure on land used for primary production and in respect of which deductions are not allowable under other provisions (e.g., the general depreciation provisions) of the Principal Act. Specifically, paragraph (h) of section 75A(1) authorises deductions for expenditure incurred on conserving or conveying water for use in carrying on primary production on the land.

The proposed insertion of new section 75B by clause 5 will cause expenditure of this kind that is incurred on or after 14 April 1980 to be eligible for an immediate deduction in the year in which it is incurred. Other expenditure covered by section 75A, such as in the draining of swamp or low-lying lands or in preventing or combating soil erosion or flooding on the land, will remain within the scope of that section.

Sub-clause (1) of clause 4 therefore proposes the omission of paragraph (h) of section 75A(1) as the expenditure

presently falling under that paragraph will, in future, be deductible under the new section 75B.

By sub-clause (2), the amendment proposed by sub-clause (1) is to apply to expenditure incurred on or after 14 April 1980 but not including expenditure incurred under a contract entered into before that date, or where the taxpayer commenced the construction, installation or extension of a structural improvement before that date. These termination arrangements complement the commencement arrangements for the new section 75B (see section 75B(6)).

Clause 5 : Deduction of expenditure on
conserving or conveying water

This clause proposes the insertion in the Principal Act of a new section - section 75B. The new section is designed to authorise an immediate deduction for capital expenditure incurred on or after 14 April 1980, by a taxpayer carrying on a business of primary production on land in Australia, on the acquisition, construction or installation of plant or a structural improvement, or an extension thereto, for the purpose of conserving or conveying water for use in that business on that land.

Expenditure that is incurred on or after 14 April 1980, either in pursuance of a contract entered into on or after that date, or where construction or installation by the taxpayer commenced on or after that date, will qualify for the new deduction.

It will not be necessary for a taxpayer to own the land on which he or she carries on a business of primary production for expenditure incurred by the taxpayer on conserving or conveying water to qualify for immediate deductibility. Nor will it be necessary for the plant or structural improvement, or an extension, to be located on that land. This means, for example, that expenditure incurred by a primary producer on the installation of a pump and piping on Crown land for the purpose of conveying water, to land leased by the taxpayer, for use in a business of primary production that the taxpayer carries on on that land, may qualify for immediate deductibility subject to the other requirements of new section 75B.

The new section is to contain appropriate safeguards against abuse. These will be patterned on safeguards that apply in relation to those provisions of the existing law that presently govern the deductibility of expenditure incurred on plant or structural improvements for the purpose of conserving or conveying water for use in a primary production business.

The new section will also provide specifically for a reduction in the amount otherwise deductible where a taxpayer

receives a total or partial recoupment of the expenditure incurred, or where the plant or structural improvement (or the extension thereto) is not wholly for use in carrying on the business of primary production, for example, where a tank is partly for use in supplying water for domestic purposes.

The provisions of proposed section 75B are explained in more detail in the notes that follow.

Sub-section (1) gives an expanded meaning to certain terms that are used in section 75B. These terms and the expanded meanings to be given to them are:

"construction" : the meaning of this word is defined to include "manufacture";

"extension" : this expression is defined as including an alteration or addition to plant or a structural improvement;

"plant or a structural improvement" : this term is defined to include a dam, earth tank, underground tank, concrete tank, metal tank, stand for a tank, bore, well, irrigation channel or similar improvement, pipe, pump, water tower and windmill.

Sub-section (2) sets out the kinds of expenditure that are, subject to the other provisions of section 75B, to qualify for immediate deductibility. Expenditure of a capital nature is to be eligible for immediate deductibility if it is incurred on or after 14 April 1980 (but see sub-section (6)), by a taxpayer carrying on a business of primary production on land in Australia, on the construction, acquisition or installation of plant or a structural improvement, or of an extension thereto, for the purpose of conserving or conveying water for use in that business on that land.

The sub-section makes it clear that expenditure to qualify under the section will cover both an original item of plant or a structural improvement, and an extension thereto. Thus, expenditure incurred on enlarging the capacity of an earth tank or improving an irrigation channel will, subject to the other provisions of the section, be eligible for immediate deductibility.

Expenditure may qualify for immediate deductibility where the taxpayer personally constructs, manufactures, extends, alters or adds to property that is within the meaning (as defined) of plant or a structural improvement, or arranges for another person to do so.

Sub-section (3) will be the operative provision of section 75B. It will authorise, subject to the succeeding provisions of section 75B, a deduction for eligible expenditure in respect of the income year in which it is incurred.

By sub-section (4), the section is not to apply to expenditure for which the taxpayer is, or becomes entitled to be, recouped from a government or other source unless the amount recouped forms part of the taxpayer's assessable income. A similar provision is contained in section 75A of the Principal Act and aims to restrict the amount deductible to the net expenditure actually borne by the taxpayer.

Where the recoupment is received in a year of income subsequent to that for which the deduction is allowable, the Commissioner of Taxation is to be authorised to effect an amendment of the taxpayer's earlier assessment (see notes on clause (6)).

Sub-section (5) is necessary to ensure that sub-section (4) may operate in a case where a taxpayer is reimbursed a single amount that relates partly to expenditure that otherwise qualifies for immediate deductibility and partly to expenditure that does not so qualify, and the amount in respect of the qualifying expenditure is not specified.

In these circumstances, the Commissioner is to be empowered, by sub-section (5), to determine the extent to which the total amount constitutes a reimbursement of expenditure otherwise eligible for immediate deductibility.

A determination made by the Commissioner under sub-section (5) will be subject to the usual rights of objection by the taxpayer, and reference to an independent Taxation Board of Review.

By sub-section (6), a deduction is not to be allowable under section 75B in respect of expenditure incurred on or after 14 April 1980 if the expenditure is incurred under a contract entered into before that date or, if incurred on the construction or installation by a taxpayer of an item or an extension thereto, that construction or installation commenced before that date.

Expenditure of this kind on an item that qualifies as plant for the purposes of section 54 of the Principal Act will be deductible by way of depreciation allowances over the estimated life of the plant. Where the expenditure is in respect of an item that does not qualify as plant, the expenditure will be deductible in equal instalments over 10 years under section 75A.

Sub-section (7) is to apply where expenditure incurred in respect of an item or an extension thereto would, apart from the operation of the sub-section, be eligible for immediate deductibility under section 75B and the relevant item or extension was not wholly for use in carrying on a business of primary production or was not wholly for use for the purpose of producing assessable income.

These circumstances could apply where, for example, an item is to convey water that is to be used partly for domestic purposes.

In such circumstances, the Commissioner is to be empowered by sub-section (7) to reduce the deduction otherwise allowable under section 75B by an amount that, in the opinion of the Commissioner, is fair and reasonable.

An opinion of the Commissioner under sub-section (7) will be subject to the usual rights of objection by the taxpayer, and reference to an independent Taxation Board of Review.

Sub-section (8) is designed as a safeguard to preclude a deduction under new section 75B in respect of expenditure incurred by a taxpayer on the acquisition of plant or a structural improvement if any person has, in respect of expenditure incurred on the construction or a previous acquisition of that plant or structural improvement, been allowed a deduction under sections 75 or 75A of the Principal Act or section 75B, or would have been allowed a deduction under any of those sections had he not been recouped in respect of that expenditure. In short, this means that where the vendor of a particular item has been allowed (or had the expenditure not been recouped, would have been allowed) a deduction under any of those sections in relation to the acquisition or construction of that item, the purchaser is not to be allowed a deduction under section 75B for the cost of acquiring the item.

Subject to the other provisions of section 75B, the purchaser may, however, be allowed a deduction under the section in respect of his or her own expenditure incurred on the installation or extension of the item acquired.

Section 75 of the Principal Act authorises an immediate deduction for expenditure incurred on or before 21 August 1973 on certain items of plant and structural improvements for the purpose of conserving or conveying water for use in a business of primary production. Section 75A authorises special deductions, by way of equal instalments over 10 years, for expenditure incurred for that purpose on items that are not within the meaning of plant for the purposes of section 54 and are therefore ineligible for the depreciation allowances available under the income tax law.

As already mentioned in the introductory notes, this non-availability of a deduction under section 75B to a subsequent purchaser of an item that has previously qualified for immediate deduction under section 75 or 75B or has been deductible under section 75A is in recognition of the fact that none of those sections provide for any balancing adjustment on disposal of such an item by the person who qualified for the deduction.

Sub-section (9) is also a safeguarding provision that is to perform, in relation to the acquisition of an extension to plant or a structural improvement, the same function as sub-section (8) is to perform in relation to the acquisition of the plant or structural improvement. As is the case with sub-section (8), sub-section (9) will not preclude the allowance of a deduction for expenditure incurred on the installation or further extension of the item acquired.

Sub-section (10) is a special provision to cover the case where a partnership incurs expenditure that qualifies under new section 75B. In these circumstances, the expenditure is not to be taken into account in the calculation of the net income of a partnership or a partnership loss, but each partner is to be deemed to have incurred so much of the expenditure incurred by the partnership as, by agreement between the partners, has been borne by each partner. Where the partners have not agreed as to the amounts of expenditure to be borne by the partners, the expenditure is deemed to have been incurred by each partner in proportion to his or her individual interest in the net income (or loss) of the partnership of the year of income in which the relevant expenditure was incurred. Each partner's proportion of the expenditure is to be deductible in the partner's own assessment, subject to the other provisions of section 75B.

A similar provision is contained in other parts of the income tax law (e.g., section 70 of the Principal Act).

Sub-sections (11) and (12) are designed as safeguards to counter any arrangements that seek to overcome the disqualification from the new deduction of expenditure incurred on or after 14 April 1980 on the acquisition or construction of property in pursuance of a contract entered into before that date, or where construction commenced before that date.

These sub-sections are modelled on provisions contained in other sections of the Principal Act, for example, section 82AL which applies in relation to the investment allowance scheme. Stated shortly, the purpose of sub-sections (11) and (12) is to prevent the allowance of a deduction under new section 75B in respect of expenditure incurred on or after 14 April 1980 where the incurrence of that expenditure is in consequence of a commitment made by a taxpayer before that date.

In broad terms, sub-section (11) applies to deny a deduction where the Commissioner is satisfied that a taxpayer entered into a contract or arrangement for the acquisition of plant or a structural improvement (referred to as the "original unit") before 14 April 1980 and, on or after that date, in order to obtain an immediate deduction in respect of the expenditure incurred on that acquisition, the taxpayer commences the construction of other plant or another structural improvement (referred to as the "substituted unit"), or enters into a contract for the acquisition of the original unit or a

substituted unit, that is to serve the same purpose as, and is intended by the taxpayer to be in lieu of, the original unit.

Sub-section (12) is designed to apply, in similar circumstances to which sub-section (11) applies, where the Commissioner is satisfied that a taxpayer commenced construction of the original unit before 14 April 1980 and subsequently enters into a contract for the acquisition or construction of a substituted unit.

Certain expressions used in sub-sections (11) and (12) are, for the purposes of those provisions, to be given expanded meanings by sub-sections (13) and (15).

Sub-section (13) is designed to ensure that a reference in sub-sections (11) and (12) to the "acquisition by a taxpayer of plant or a structural improvement" is to include construction of the plant or structural improvement for the taxpayer by another person or other persons.

Sub-section (14) of proposed section 75B contains anti-avoidance provisions designed to prevent misuse of the new deduction through inflation of the amount of the expenditure incurred. Its provisions closely follow those of section 57AE(3) which governs the special deductions available to primary producers for on-farm structural improvements for the storage of grain, hay or fodder. The sub-section is to apply, broadly, where, in relation to expenditure that is eligible for the new concession, the Commissioner is satisfied that the parties were not dealing with each other at arm's length and the expenditure sought to be deducted exceeds the amount that would have been incurred had the parties dealt with each other on an arm's length basis. In these circumstances the sub-section operates to deem the arm's length amount to be the amount of expenditure that, subject to the other provisions of the section, will qualify for immediate deductibility.

Sub-section (15) is a drafting measure designed to ensure that a reference in sub-sections (11), (12), (13) and (14) to "plant or a structural improvement" will include a reference to a portion of, or an extension to, plant or a structural improvement.

Clause 6 : Amendment of assessments

This clause will amend section 170 of the Principal Act which governs the power of the Commissioner of Taxation to amend income tax assessments. Sub-section (10) of section 170 provides that nothing in the section is to prevent the amendment of an assessment at any time for the purpose of giving effect to specified provisions of the Principal Act.

Clause 6 will insert in section 170(10) a reference to sub-section (4) of new section 75B that is proposed to be inserted in the Principal Act by clause 5 of the Bill. As amended, section 170(10) will enable the Commissioner to give effect to section 75B(4) by amending, at any time, the assessment of a taxpayer who has been recouped expenditure that has been allowed as a deduction under section 75B in an assessment of income of a year of income that preceded that in which the amount of recoupment is received.