



ATO Interpretative Decision

ATO ID 2006/327

Income Tax

Capital Allowances: balancing adjustment event - 'section 73BA depreciating asset' - existing full-scale test model - discontinued use

FOI status: may be released

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Issue

Does a balancing adjustment event occur under paragraph 40-295(1)(b) of the *Income Tax Assessment Act 1997* (ITAA 1997) for the existing full-scale test model of the taxpayer's 'section 73BA depreciating asset' if the taxpayer discontinues use of the test model because it could not operate in the manner required?

Decision

Yes. A balancing adjustment event does occur under paragraph 40-295(1)(b) of the ITAA 1997 for the existing test model of the taxpayer's 'section 73BA depreciating asset' because the taxpayer stopped using the asset, or having it installed ready for use, for any purpose and expected never to use it, or have it installed ready for use, again.

Facts

The taxpayer is an 'eligible company', as defined in subsection 73B(1) of the *Income Tax Assessment Act 1936* (ITAA 1936), that carries on 'research and development activities' (R&D activities) as defined in subsection 73B(1). The taxpayer has registered its R&D activities in the manner contemplated by subsection 73BD(1) of the ITAA 1936. The subject matter of the taxpayer's R&D activities is an item of equipment capable of performing a specific manufacturing process. The taxpayer's R&D activities encompass not only designing and developing the item of equipment but also testing the performance of the asset against the requisite specifications.

As an integral part of the R&D activities, the taxpayer built a full-scale model of the item of equipment for the purpose of testing the asset's capacity to perform the specific manufacturing process at a commercially viable level. The test model is not an item of trading stock of the taxpayer and the expenditure on the test model does not represent 'feedstock expenditure' within the meaning of that term in subsection 73B(1) of the ITAA 1936. The test model was constructed after 29 January 2001 and no deduction under subsection 73B(15AA) of the ITAA

1936 is allowable in relation to it (see subsection 73B(15AAAA) of the ITAA 1936). However, testing revealed that the existing model could not operate in the manner required and that a major revision of the equipment's design and functionality was needed to successfully continue with the R&D activities. The existing test model is a 'section 73BA depreciating asset' as defined in section 73BB of the ITAA 1936 and the taxpayer started to hold that asset from when they first built it. For the period of time that the taxpayer utilised the asset for monitoring and testing purposes in its R&D activities, deductions under subsection 73BA(2) of the ITAA 1936 have been allowed.

In view of the major revision required, any further use of the existing test model was abandoned in favour of building a completely new test model. As many of the components of the existing test model were of significant value, the existing test model was dismantled and those components of value retained and stored. Other less valuable components were discarded. Some of the components retained from the existing test model were ultimately used as components in the new test model even though both the functionality and physicality of the new test model were materially different to the existing test model.

Reasons for Decision

Section 73BF of the ITAA 1936 requires a balancing adjustment to be made to the assessable income of an 'eligible company' if a balancing adjustment event happens in relation to the company's 'section 73BA depreciating asset' and the taxpayer has been allowed deductions for the asset wholly under section 73BA of the ITAA 1936. Although not relevant here, if deductions for the taxpayer's asset have also been allowed under section 40-25 of the ITAA 1997, a balancing adjustment is also required to be made under section 40-285 (as modified by section 40-292) of the ITAA 1997.

As stated in the facts, the taxpayer is an 'eligible company' and the existing test model is a 'section 73BA depreciating asset'. The taxpayer has been allowed deductions for the asset wholly under section 73BA of the ITAA 1936.

A balancing adjustment event for the purposes of section 73BF of the ITAA 1936 has the meaning of that phrase in section 40-295 of the ITAA 1997.

As far as is relevant here, paragraph 40-295(1)(b) of the ITAA 1997 states that a balancing adjustment event occurs for a depreciating asset if the holder of the asset stops using it, or having it installed ready for use, for any purpose and expects never to use it, or have it installed ready for use, again.

When the existing test model could not operate in the manner required, the taxpayer decided that it could no longer be usefully employed to test the taxpayer's R&D activities. Consequently, a completely new test model was built by the taxpayer involving material differences in design, functionality and physicality. The taxpayer had no other use for the existing test model and, so, proceeded to dismantle it and discard some of its components. The fact that components of value were retained or that some of them were ultimately re-used in building the new test model does not detract from the view that the taxpayer permanently stopped using the existing test model, or having it installed for use, for any purpose and expected never to use it, or have it installed ready for use, again.

Accordingly, a balancing adjustment event occurred under paragraph 40-295(1)(b) of the ITAA 1997 for the existing test model of the taxpayer's 'section 73BA depreciating asset'.

Date of decision: 25 August 2006

Year of income: 30 June 2004

Legislative References:

Income Tax Assessment Act 1936

- subsection 73B(1)
- subsection 73B(15AA)
- subsection 73B(15AAAA)
- section 73BA
- subsection 73BA(2)
- section 73BB
- subsection 73BD(1)
- section 73BF

Income Tax Assessment Act 1997

- section 40-25

section 40-285
section 40-292
section 40-295
paragraph 40-295(1)(b)

Related ATO Interpretative Decisions

ATO ID 2006/328

Keywords

Balancing adjustment event
Depreciating assets
Depreciating asset - section 73BA
Research and development plant
Uniform capital allowances system

Date of publication: 1 December 2006

ISSN: 1445-2782

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