Fixed assets – a case for further inspection

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In brief

The tax fixed asset register is considered by many to be a sleeping giant, approached with great care for fear of uncovering more problems than opportunities. However, if carefully appraised with regard to the range of alternative choices and methods available under the capital allowances regime, the tax law could result in material savings for taxpayers.

Many taxpayers maintain their fixed asset profile on a similar basis for both accounting and tax purposes, subject to a few obvious exceptions such as applying different calculation methodologies or using certain designated effective lives for tax purposes. Organisations with more sophisticated tax functions may employ a greater level of diligence and control over identifying opportunities within the tax fixed asset register, such as optimal depreciation methodologies on an asset class basis or utilising the lowest available effective lives, however even then there is generally a limit as to how much time and effort a business is willing to spend on this aspect of its tax profile. This has been especially true over the more prosperous times earlier this millennium. As businesses grew rapidly, little attention was paid to potential differences in the book and tax treatment of assets. Why would a business dedicate resources to this, especially when any benefit was just timing in nature?

This attitude is understandable in more profitable conditions, however over recent years we have seen clients develop a greater interest in understanding the opportunities available within their tax fixed asset profile. Notwithstanding book to tax differences may just be timing in nature, for capital expenditure intensive industries such as mining, energy, utilities or social and economic infrastructure providers, there may be significant benefit in bringing deductions forward under the current economic climate to assist in cash flow management and relieve financing pressures.

The required analysis has been aided in more recent times by technology innovations and improvements. We have seen the introduction of intelligent software tools which can be utilised to scrutinise high volumes of data to identify risks and opportunities. For example, with the right level of investment, it may be appropriate to use analytical applications to automate logic and integrity reviews of the tax fixed asset register over thousands of line items, which traditionally would have been a time consuming and costly exercise given the volume of data often involved. This may assist from an audit and risk prevention perspective, or to ensure that the tax depreciation profile of the organisation is correctly optimised.

This article considers the opportunities available to optimise the tax position, but also the areas to be careful about when considering amending prior year positions adopted.

In detail

How can accounting and tax recognition criteria differ?

As noted above, in our experience accounting fixed asset recognition and depreciation criteria can often be used as the starting point for an organisation's tax position. To highlight the variety of situations in which this approach may not be appropriate, we have outlined below some examples of areas in which the treatment of fixed assets may differ for accounting and tax purposes.

Aspect	Examples
Depreciation methodologies	• For tax purposes, items of depreciable plant may generally be written off using either the prime cost or diminishing value methods. Taxpayers may choose which method to apply on an asset-by-asset basis, with the exception of particular assets for which a statutory method may be designated. • For accounting purposes, methodologies available include straight-line (akin to prime cost), reducing balance (akin to diminishing value) or units of production (no equivalent available in the tax law). The method to be selected for accounting purposes should reflect the pattern in which the asset's economic benefits are consumed.[1] • Accounting depreciation methodologies also apply the concept of residual cost, which effectively reduces the depreciation claimable each year in respect of the cost of an asset to reflect the value which may be realised at the end of its expected useful life. This will generally result in a variance between tax and accounting depreciation regardless of consistencies between the effective life and depreciation method chosen. • Alternative methodologies may be available for tax purposes, including use of a low value or software development pool,[2] project pools for certain expenditure including mining and transport capital expenditure,[3] and the capital works regime for buildings.[4] • For tax purposes, capital expenditure may be written off evenly over five years under the business related capital expenditure provisions[5] where it does not form part of the cost of an asset held by a business for tax law purposes, subject to exceptions.
Effective lives	• A taxpayer may choose to depreciate an asset over either the effective life recommended by the Commissioner in the relevant tax ruling published for that year,[6] or may self-assess the effective life of the asset where relevant commercial, technical or economic conditions support a different life. For certain assets, such as designated intangibles or mining rights, the tax law provides a statutory life which must be used.[7] • The tax law applies a capped life to certain assets where a taxpayer is relying on the Commissioner's recommended life, but the capped life is lower. This includes certain commercial vehicles, and assets used in oil and gas production, distribution and transmission.[8] • A taxpayer can recalculate the effective life previously applied to an asset if the circumstances relating to the use of the asset have changed or the cost of the asset is increased by greater than 10 per cent in that year.[9] • The depreciation method to be applied to assets for accounting purposes is also subject to continual testing and potential recalculation where factors relating to the use of that asset change.
Determination of cost	• There may be instances where the "cost" of an asset which is capitalised can differ for accounting and tax purposes. This will depend on the relevant accounting costing

[1] Paras 60-62 of AASB 116.
[2] Subdiv 40-E of the *Income Tax Assessment Act 1997* (Cth) (ITAA97).
[3] Subdiv 40-I ITAA97.
[4] Div 43 ITAA97.
[5] S 40-880 ITAA97.
[6] See TR 2016/1 for the ruling applicable to assets acquired from 1 July 2016.
[7] S 40-95 ITAA97.
[8] S 40-102 ITAA97.
[9] S 40-110 ITAA97.

	approach adopted and the nature of the expenditure for tax purposes. The classification of certain material assets as a stand-alone "unit of property" or composite parts of a broader asset under the tax law may merit further consideration. • Accounting cost allocation methodologies are considered in detail in the ATO's discussion paper regarding internal labour costs[10] and has been subject to subsequent ATO interpretative decisions.[11] As noted by the ATO, in many cases, the treatment of capitalised costs for tax purposes will be a question of fact and degree and should be considered on its own facts. • Repairs and maintenance capitalisation policies applied for accounting purposes may, in some cases, be either wider or narrower than the concepts to be applied for tax purposes.[12]

I haven't paid due attention to my tax fixed asset register – can I go back and amend?

Many of the choices available under the capital allowances regime depend on adopting the relevant tax depreciation or recognition methodology in respect of the year in which the assets is first acquired, or when the relevant change in economic conditions or use of an asset occurs. When clients realise retrospectively that an opportunity to apply an alternative treatment for tax purposes in the fixed asset register has been missed, we are often asked whether it is possible to amend prior year returns to reflect the desired treatment.

Large businesses may generally request the Commissioner amend an assessment for an income year within four years after the day on which notice of the original assessment was given to the taxpayer.[13] It is important to note that, for companies, the date the relevant return is lodged with ATO is deemed to be the date on which the notice of assessment has been received from the Commissioner.[14]

The decision to submit an amendment request should be considered carefully, and take into account all legal and practical obligations for the taxpayer. We have noted below two particular factors which should be considered when determining whether a prior year amendment can be made.

Can the treatment previously applied be changed by way of amendment?

An amendment request is designed to correct mistakes or omissions the taxpayer may have inadvertently made on an income tax return, or that the ATO may have made in their assessment.[15] This may be required for a variety of reasons, including incorrect recognition of capital allowance adjustments.

It is important to note, however, that the choices which may be adopted under the capital allowance regime are subject to section 40-130 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97), which states that a choice under Div 40 ITAA97 can only be made by the day a taxpayer lodges its income tax return for the year to which the choice relates, or within a further time allowed by the Commissioner.

This choice cannot be altered by an amendment request pursuant to section 170 of the *Income Tax Assessment Act 1936* (Cth).

Choices which are made by a taxpayer under Div 40 may include depreciation methodology to be applied, effective life to be adopted, use of low value pools, recalculation of effective life of an asset, and other choices which may affect the tax profile of the relevant asset. As such, a choice must be made by the time the relevant tax return is lodged for that year, any retrospective modification to this choice may only be done where the Commissioner allows further time to do so in accordance with section 40-130(1)(b).

In the event that the Commissioner does allow further time pursuant to s 40-130(1)(b), an amendment request that amends the particulars of an assessment to reflect the modified choice may be lodged.

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[10] ATO, "Income tax treatment of direct internal labour costs incurred on self-constructed depreciating assets", discussion paper, 8 July 2008.
[11] ID 2011/42, ID 2011/43 and ID 2011/44.
[12] TR 97/3.
[13] S 170 of the *Income Tax Assessment Act 1936* (Cth) (ITAA36).
[14] S 166A ITAA36.
[15] Para 1 of PS LA 2008/19.

Can a valid amendment be made in respect of a "particular"?

Another consideration in amending an income tax return for fixed asset adjustments is whether the item in question has been subject to a previous unrelated amendment by that taxpayer.

Under section 170(3), if a previous amendment has been made in respect of a "particular" which had the effect of reducing the taxpayer's liability, and the Commissioner "accepts a statement made by the taxpayer in making the amendment", the Commissioner may only make a further amendment in respect of that particular in way that *increases* the taxpayer's liability. In other words, once a particular item in a return is amended downwards by virtue of a statement made by the taxpayer, that item may only be amended again to the extent it increases the income tax liability for the relevant year.

Given the complexity of the tax fixed asset register and the potential for multiple adjustments to be required over time for unrelated items within the register (e.g. true up reviews or additional information coming to light), taxpayers need to be wary of the mechanics of the amendment provisions within section 170. Given the wide and potentially interpretative nature of the term "particular" used in this context, it is conceivable that one minor amendment in respect of a taxpayer's fixed asset register, which has the effect of reducing the tax liability for that year, may prohibit that taxpayer from making any further fixed asset amendments notwithstanding the four-year window.

The takeaway

There are many opportunities to optimise the cash flow profile of your business by taking advantage of available choices and methodologies under the capital allowances regime. Caution should be applied however in amending returns to ensure any amendment is valid. If such a task is approached with requisite diligence and through the lens of new technologies and analytical opportunities, taxpayers may start to view the tax fixed asset register as a way to enhance cash flow and relieve financing pressures, as opposed to the compliance nightmare which it can so often become.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

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