

Depreciation for Primary Producers

Plant and equipment-Rusting away?

Tax depreciation on plant and equipment. Well I ask you – Is there any subject more droll than this - watching the grass grow perhaps? Listening to a parliamentary session perhaps? No, I am informed that the readers are awaiting a dissertation of unbounded thrilling content on this subject-so don't say you weren't warned.

From the 1st July 2001 the Uniform Capital Allowance system was introduced to cover deductions for the reduction in value of depreciating assets. Assets acquired prior to that date may be treated differently from the manner outlined in this article. I told you its awful but read on it gets better.

Depreciating Asset

A depreciating asset is one that has a limited life and is expected to decline in value over the period of time in which it is used. Plant and machinery fit within this group however livestock, buildings and structural improvements do not. Yes, Yes, I know-we all have a limited life and decline starts early its just that most of us don't want to recognize it.

Effective Life

The effective life of an item of plant is the period of time which the item can be used for income producing purposes irrespective of the fact that an owner may dispose of the plant before its useful life is ended. If you could apply this principle to your kids I guess it would start at 22 and ends when you join your ancestors-except it does not produce an income but rater is a drain on the exchequer..

It is possible to self asses the effective life of an item of plant however the Australian Taxation Office has detailed its opinion of the life of many items of plant and equipment in Tax Ruling TR2000/18.(Go to www.ato.gov.au then locate Tax Rulings and locate TR2000/18C9 , which is the consolidated table up to 1 July 2005 . Download the Adobe file and look under Table A or B)

The Table A list is by industry. If you are covered by one of these industries then you should use the effective lives shown in this Table. If you are not covered by the industries in Table A then you go to Table B which lists effective lives for a long list of specific assets. If your asset falls within this list you use this Table. If not you have to self assess the useful life of your asset. (Simple-isn't it?-It's a bit like the monopoly game you played years ago-Remember-If you throw a three you go to jail, if you throw a five you go to jail for longer and any other possible number you lose a sheep station.)

This ruling deals with new plant and you are free to self asses the effective life of second hand plant or new plant if you feel that special circumstances exist. It is probably very wise to use the Tax Office effective lives as they constitutes a" safe harbour" where the lives used do not have to be shown to be reasonable in the event of a tax audit or enquiry.

It should be noted that the Tax Commissioner has advised that a review is being undertaken of the useful lives of assets used in primary production-specifically in the areas of beef, dairy, sheep, grains, horticulture and crops, and Nurseries, cut flowers and seed growing. This review is likely to be completed around 1 January 2007 . You can bet that this review will make it even easier to go to jail or go back seven spaces.

Cost of an Asset

The cost of an asset includes the following-

- acquisition cost (exclusive of GST)
- installation costs
- freight charges
- import duties

Now if you are like a few people I know (including my esteemed chairperson) and have difficulty balancing the cheque book then I suggest you skip the next few paras and go to the heading titled “The choice of depreciation method”. You can come to a quick decision and tell your accountant –That’s for me!

Methods of Depreciation

Once the cost and effective life of an asset has been determined it will be necessary to decide whether to use either of the Prime Cost or the Diminishing Value method of depreciation. Either method can be used at the option of the taxpayer however once made it cannot be changed for that particular asset.

In order for depreciation to be deductible an asset must be in use or ready for use. In addition an asset not fully used for business purposes (e g for private purposes) cannot be fully depreciated for tax purposes.

Example

A compressor is purchased on 1 July 2004 however the installation requires 3 phase power to be installed and the local electricity company is unable to complete the installation of the requisite cabling until 30 September 2004. Even though the plant has been acquired, and installed by the supplier it is not ready for use until 30 September 2004 and depreciation will commence from that date.

Example

A fax machine is acquired on 1 October 2004. Records indicate that the fax machine is used for business purposes to the extent of 50% and the balance for private purposes. Depreciation would be calculated for 9 months and would be deductible to the extent of 50%.

Prime Cost Depreciation Method

The yearly deduction for a depreciating asset is determined by first deciding the effective life of the item. Then the depreciation is calculated by dividing 100 by the effective life in years to work out the annual depreciation rate and multiplying this rate by the cost of the asset to determine the depreciation deduction for the year. This is the depreciation expense for each year until the asset is fully depreciated. (An apportionment on a time basis may be required in the first year if the asset is acquired during the year.)

Example

A harvester is acquired on 1 July 2004 for \$90,000. The effective life as per the Tax Office Ruling is 6 2/3 years. Dividing 100 by 6 2/3 gives us a depreciation rate of 15% and a depreciation deduction in the first year of \$13,500. The deduction in the following 5 years is also \$13,500 with the balance being written off in the seventh year.

	Opening WDV \$	Depn \$	Closing WDV \$
Year 1	90,000	13,500	76,500
Year 2	76,500	13,500	63,000
Year 3	63,000	13,500	49,500
Year 4	49,500	13,500	36,000
Year 5	36,000	13,500	22,500

Diminishing Value Method

The deduction for a depreciating asset under this method is again determined by deciding the effective life of the item. Then the depreciation rate is calculated by dividing 150 by the effective life. This rate is then applied to the written down value of the asset at the beginning of the year to calculate the depreciation deduction for the year.

Example

Using the same harvester costing \$90,000. The effective life is 6 2/3 years. Dividing 150 by 6 2/3 give an annual depreciation rate of 22.5 %. The annual deduction is then -

	Opening WDV \$	Depn \$	Closing WDV \$
Year 1	90,000	20,250	69,750
Year 2	69,750	15,694	54,056
Year 3	54,056	12,163	41,893
Year 4	41,893	9,426	32,467
Year 5	32,467	7,305	25,162

The Choice of Depreciation Method

Under the Diminishing Value method the depreciation deductions are higher in the earlier years but gradually fall towards the end of an assets effective life. On the other hand the prime cost method provides an equal deduction in each year and the asset is fully written off much earlier. In the early years therefore the Diminishing Value method provides a higher level of deductions but the position reverse in later years.

The choice is at the option of the taxpayer. There is no doubt that where the higher level of deductions can be offset against taxable income that the Diminishing Value method provides the better option by giving the higher deductions in the first few years. (For example in the case of a partnership where losses are offset against other income.) The prime cost method would be preferable where there are extensive start-up losses that cannot be offset against other income.

In summary – If you want to pay less tax this year then choose the Dimishing Value method.

Low Value Pools

You want a great piece of free advice – the sort of stuff you ask a tax person at a party after you have had a couple of gins- This is it. A great way to get an extra few deductions. Really in the tax regime it doesn't get better than this.

Assets costing less than \$1,000 and assts that have been written down to less than \$1,000 can be placed in a low value pool and depreciated based on an effective life of 4 years.

Depreciation rates for the low value pool are 18.75% for assets purchased in the current year and 37.5% for the closing value of the pool from the previous year and those assets written down to less than \$1,000 and transferred into the pool at the beginning of the year.

Example

A primary producer has a plough which has been depreciated to \$900 as at 30 June 2004, has acquired a second hand post hole digger for \$750 on 1 July 2004 and a hand sprayer for \$500 on 30 September 2004. He decides to utilize the low value pool.

2004/5 Year

	Opening WDV \$	Additions	Rate	Depn \$	Closing WDV \$
Plough	900		37.5	338	562
Post Hole Digger		750	18.75	141	609
Hand Sprayer		500	18.75	94	406
Totals	900	1,250		573	1,577

2005/6 Year

No other purchases are made in the 2005/6 year that fall into the low value pool

	Opening WDV \$	Additions	Rate	Depn \$	Closing WDV \$
Pool Balance	1,577		37.5	592	985

Disposals of Assets

The disposal or scrapping of an asset will produce a deduction if there remains a written down value after taking into account any proceeds of sale (underdepreciated) or an assessable amount if the asset has been over depreciated. These amounts are known as balancing adjustments.

Capital Works

A deduction can be claimed for capital expenditure incurred in the construction of income producing buildings and a variety of structural improvements such as roads driveways, car parks, bridges retaining walls etc. The deduction is a percentage of the cost of construction and the rates vary between 2.5% and 4 % depending on the date the building was constructed and the use of the building.

These deductions fall under 4 categories-

- Short Term Traveller accommodation
- Income producing - residential
- Income producing - Non Residential-includes shops, offices etc
- Manufacturing - includes building used principally for manufacturing, processing of primary products, etc

Software

Acquired computer software is deemed to have an effective life of 2.5 years.

Conclusion

Well I told you it would be scintillating stuff -you didn't believe me - I knew it. If you don't like all that accounting gobbledegook and tax paraphernalia then my suggestion is this - get a super accountant -then read great little articles like this and note down a couple of points that seem like they are really smart - like low value pools – and go and ask him what he thinks of them and whether they would save you some tax. At worst you will impress him no end with your knowledge and at best you might just catch him out on something missed in your tax for the year. If you are a small acreage farmer then ask him about the Simplified Tax system - some gems here too. Good Luck.

Disclaimer

The information in this article has been presented as a guide only as individual circumstances vary. You should consult your accountant or tax advisor to provide specific advice on your activities.



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