



James Beeston
Australian Taxation Office
GPO Box 9990
SYDNEY NSW 2000
Via email: James.Beeston@ato.gov.au

Dear Mr Beeston,

Re: Capital Asset Labour Costs Draft Taxation Ruling (TR 2019/D6)

Infrastructure Partnerships Australia welcomes the opportunity to provide a submission in relation to the draft Taxation Ruling TR2019/D6 *Income tax: application of paragraph 8-1(2)(a) to labour costs and associated costs incurred in respect of the construction or creation of capital assets* (the **Ruling**) published on 21 November 2019.

To summarise, we consider the reasoning and analysis in the Ruling and Appendices could be more balanced and the examples could be expanded upon to ensure taxpayers have sufficient practical guidance to apply the Ruling. In our view, the approach to the drafting of the Ruling should be reconsidered if it is to become a public ruling relevant to a broad range of taxpayers.

1. General Comments

- 1.1. As a general comment, we would agree that a long-standing area of complexity in applying Australian tax law is assessing whether a particular outgoing has the character of capital or revenue. Whilst in many circumstances the appropriate characterisation of expenditure is not contentious, in other cases the position can be far from clear. Consequently, any effort to provide clarity is to be welcomed.
- 1.2. Unfortunately, in our view, the Ruling itself does not do much to resolve this uncertainty in relation to the treatment of labour costs incurred in connection with capital projects. The Ruling largely restates broad principles that themselves are well understood to be the views of the Commissioner.
- 1.3. In our view it is more relevant to draw a distinction between labour costs incurred for staff engaged on a general basis that may, from time to time, be working on matters of a capital nature as compared to labour costs incurred directly in relation to, and solely for, the purpose of the construction of an asset. The concepts and positions outlined in the Ruling should be further expanded and include, for example, when labour costs may be revenue and not capital in nature.





Principles of capital and revenue relevant to labour costs and associated costs

- 1.4. The Explanation to the Ruling in paragraph 33 sets out that determining the extent to which expenditure is capital or revenue in nature should not be done with reference to isolated quotes from decisions that might be argued to support a particular proposition. However, with respect, in our view the analysis in the Ruling does exactly that to support the Commissioner's view.
- 1.5. One example is the principle attributed to *Goodman Fielder*¹ in paragraphs 6 and 47. *Goodman Fielder* states that the specific purpose for which a person is employed is a relevant factor when considering the character of the advantage sought; however, in our view this is not appropriately made clear in the Ruling.
- 1.6. In our view, the entirety of the quote from *Goodman Fielder*, reproduced below, should be incorporated as part of the Ruling as in our view it represents a more balanced approach to considering the character of the advantage sought:

*"Where a person is employed for the **specific purpose** of carrying out an affair of capital, the mere fact that that person is remunerated by a form of periodical outgoing would not make the salary or wages on revenue account. On the other hand, where an employee is employed and engaged in activities which are **part of the recurring business of a company**, the fact that he may, on a particular day, be engaged in an activity which viewed alone would be of a capital kind, does not operate to convert the periodical outgoing for salary and wages into an outgoing of a capital nature. In between, there will be cases where it may be difficult to determine whether the expenditure should properly be regarded as on capital account or as on revenue account. Each case will depend upon its facts but the answer will not be derived merely by counting the number of hours in which the employee is engaged in activities which themselves may be said to involve matters of capital. Further, it will be necessary to determine whether the **essential character of the expenditure is that it is a working expense**. If it is, then it will ordinarily be on revenue account."* [own emphasis]

- 1.7. *Goodman Fielder* states that the specific purpose for which a person is employed is a relevant factor when considering the character of the advantage sought, however, as noted above this is not adequately addressed in the Ruling. Paragraph 47 of the Ruling does reference a passage from the case relevant to this point; however, it is used to support the Commissioner's contention that a periodical outgoing does not make salary or wages on revenue account whilst ignoring the importance of the first part of the quote. The same comment can also effectively be

¹ *Goodman Fielder Wattie Ltd v Commissioner of Taxation* [1991] FCA 206.





said about the references made to the *Star City*² case [refer to paragraph 44] where the draft Ruling appears to gloss over the reference to the fact that the quote refers to employees being “engaged wholly upon” the capital works.

- 1.8. It is this factor which the IPA considers is the main determinant of the tax treatment of labour costs. That is, where the employee is employed solely to do capital works then their salary should be on capital account. There is no disagreement that where a third-party contractor is engaged on a capital project that such expenditure would be on capital account.
- 1.9. To this point, we consider paragraph 39 is too simplistic in its conclusion that labour costs incurred in respect of the creation/acquisition of a capital asset are capital in nature simply by reference to broad conclusions made in the preceding paragraphs.
- 1.10. Another example of this is the statement in paragraph 38. The Commissioner states that when considering the character of the advantage sought, the reference in *GP Pipecoaters*³ to the “asset acquired” is a reference to the capital asset being created or acquired in the case of labour costs. This conclusion is formed by taking one statement in one case and using this to support an outcome without any supporting analysis. Applying the same approach, it can equally be argued, when taking the other reference in *GP Pipecoaters* to the liability discharged, that the payment of labour costs is simply the discharge of a liability owing under an employee contract for services provided.
- 1.11. A notable exclusion from cases discussed in the draft Ruling is the case of *Associated Minerals*,⁴ which supports the view that employment related costs regarding the destruction and removal of capital assets are deductible. This is one of very few cases that addresses the issue of labour costs incurred in relation to capital assets and should be addressed in the Ruling.
- 1.12. We recommend that the Explanation have regard to the entirety of the case law before any conclusions are formed.

Apportionment

- 1.13. The guidance in the Ruling with regard to apportionment does not adequately address the importance of this issue and the current uncertainty taxpayer’s face in applying these principles.
- 1.14. In relation to the issue of apportionment, the draft Ruling and the appendices should be updated to more appropriately reflect the wording of section 8-1 itself (i.e. amounts are considered to be deductible except to the extent they may be capital in nature) as well as the

² *Commissioner of Taxation v Star City Pty Limited* [2009] FCAFC 19.

³ *GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation* (1990) 170 CLR 124.

⁴ *Associated Minerals Consolidated Ltd v Federal Commissioner of Taxation* (1994) FCA 570.





case law on apportionment including for example, *Ronpibon Tin*⁵ (which is only referenced as authority that apportionment should be conducted using a fair and reasonable basis).

- 1.15. We agree with the principle that apportionment cannot only have regard to the number of hours spent by an individual employee in relation to matters of a capital nature. In the next version of the draft Ruling, we suggest that the Commissioner set out other principles he considers are relevant to the question of apportionment.

Relevance of accounting principles

- 1.16. We submit that a disproportionate percentage of the Ruling is spent addressing the relevance of accounting principles as compared to the other components of the judgement in *Sun Newspapers*.⁶
- 1.17. The paragraphs included as part of this section do not highlight the extent of the discretion available to organisations to treat expenditure under accounting standards. For example, items are frequently capitalised for accounting purposes which are in reality repairs for tax purposes.

2. Broader implications

- 2.1. The strict approach the Commissioner is proposing could have a significant impact on the cost of labour and overall capital costs in Australia required to deliver large scale projects when the immediate tax deduction for such a broad range of labour costs is removed.
- 2.2. We recommend against drafting a Ruling of such broad application and urge the Commissioner to provide more practical guidance for taxpayers.
- 2.3. The impact of the Ruling on industries such as infrastructure cannot be underestimated. We would suggest that, prior to its finalisation, more extensive consultation must be undertaken, and the examples and guidance in the Ruling be expanded if it is to provide greater certainty to taxpayers in relation to these issues.
- 2.4. Further, the positions adopted by the Commissioner in the Ruling appears to be broader in approach than positions previously adopted in ATOID 2011/42 and ATOID 2011/43 in relation to the electricity industry. Specifically, under the above ATOIDs, labour costs for teams involved in construction were treated as capital however overheads were not explicitly included in this category. The Commissioner should clarify this position in the Ruling as to the ongoing application of the relevant ATO interpretive decisions.

⁵ *Ronpibon Tin NL v Federal Commissioner of Taxation* (1949) 78 CLR 47.

⁶ *Sun Newspapers v Federal Commissioner of Taxation* (1938) HCA 73.





3. Date of effect

- 3.1. The draft ruling indicates that the Ruling will be both retrospective and prospective. Given the position put forward in the Ruling appears to be contrary to some positions adapted previously, it would be preferable if the Ruling, once finalised, should only be prospective.

Conclusion

With reference to the issues described above, Infrastructure Partnerships Australia looks forward to further clarification being provided in the ATO's forthcoming Exposure Draft.

If you have questions on any of the above, please contact Infrastructure Partnerships Australia's Director of Policy & Research, Jon Frazer at jon.frazer@infrastructure.org.au.

Sincerely,



ADRIAN DWYER

Chief Executive Officer

