Statutory depreciation regimes for intangible assets

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Abstract

Currently, Australia's uniform capital allowance system does not include a single mechanism for recognising the cost of intangible wasting assets. Instead, it has a number of separate and to some extent inconsistent regimes for different types of assets recognised by statute. It has been suggested that Australia should adopt a single mechanism to enable the tax system to accurately measure net income. However, implementing this suggestion would be ineffective without an in-depth understanding of the existing depreciation rules that apply to certain types of intangible assets. This article examines the history of the rules relating to four categories of depreciating assets and the policies underlying them: 1) rights and information in the resource industry; 2) intellectual property, other than trademarks, protected by statute; 3) in-house software; and 4) statutory or contractual rights relating to media and telecommunications. While these intangible wasting assets differ significantly, reviewing the depreciation rules for each category provides useful insights for building a new universal depreciation regime that can apply to all intangible wasting assets.

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1 Introduction

The earliest federal income tax legislation in Australia denied immediate tax deductions for capital expenses. Instead, it allowed depreciation deductions for the cost of acquiring wasting assets. Even though various types of intangible assets were recognised by statute at the time, the original tax depreciation rules were limited to tangible wasting assets. During the first few decades of the federal income tax system, new depreciation rules were added for several types of intangible assets created by statute – specifically, mining rights, copyrights and patents. The rules did not extend to expenses for other types of intangible wasting assets, such as private contracts or government-issued licences or rights, though costs relating to many of these were recognised later under other rules, including the capital gains tax regime. In the 1990s, further depreciation rules were added as a subset of the rules pertaining to copyrights protecting in-house computer software and various communication rights such as spectrum access rights provided by the government.

From the government's perspective, the depreciation rules for tangible and intangible assets alike have been a useful tool for implementing various economic policies. In the last century, the rules have been modified repeatedly to subsidise policy objectives ranging from supporting the Australian resource industry to promoting Australian film and television production. While the tax expenditure implications of the depreciation rules for tangible assets have been subject to some analysis in the past, relatively little attention has been paid to depreciation for intangible assets as a means of achieving a neutral income tax base. This article traces the evolution of the depreciation system for intangible assets and the dual role it has played in providing cost recognition for wasting assets and in subsidising certain industries. In particular, it reviews the past and present rules on intangible assets depreciated under the uniform capital allowance regime, such as mining, prospecting and quarrying rights and information; patents, copyrights and registered designs; software purchased or developed in-house; and statutory and contractual rights in the media and telecommunications industries.[1]

The review shows the difficulty involved in determining the effective life of wasting intangible assets in present rules and the impediments to measuring a neutral income tax base to achieve fairness in the tax system. The current tax law also makes it difficult to accurately measure annual net income because costs of many intangible wasting assets are recognised under the capital gains tax regime. This article proposes a universal depreciation system to address these problems. This not only improves consistency and restores the fragmentation of current depreciation rules, but also allows a broad range of wasting intangible assets to be depreciated consistently and coherently.

2 Mining, quarrying and petroleum rights and information

Tenements and other leases acquired for mining purposes are hereafter collectively called 'mining leases' or the 'rights' to prospect or mine in a particular area. A mining lease may be acquired by a person who primarily carries on prospecting activities or by a mining or petroleum enterprise that prospects as well as developing and producing resources. A

1 *Income Tax Assessment Act 1997* s 40-30. A brief summary of the interaction between tax regimes can be found in Andrew O'Bryan, 'Building, Buying, Holding, Selling and Valuing Intangible Business Assets' (Convention Paper, Taxation Institute of Australia, 13 March 2009).

mining lease can be acquired from a government authority or transferred on the market. Similarly, mining information can be transferred on the market based on the value of what is discovered through prospecting activities. These intangible assets play a vital role in mining, quarrying and petroleum operations and as such, are highly valuable.

Mining operations are undertaken in stages and profits eventuate only after extensive exploration and development, which requires significant sunk costs and capital outlays over a long period. Generally, mining generates income in the final stage of extraction activities (before rehabilitation), a fact that the tax system must recognise. In the past, several options have been suggested to account for the time gap between using economic resources and reaping the economic benefits of a going mining concern, with the goal of improving market efficiency.[2] However, determining the best timing for recognising costs and measuring profits for tax purposes remains a difficult task. Although there is no fixed rule for allocating the cost of acquiring mining rights and information, standard accounting practice could be adopted to allow for depreciation of these intangible assets, which would be consistent with the way tangible assets are treated for tax purposes. In accounting, capitalisation of an expense is based on whether an economic resource is expected to provide benefits in the future.[3] In this regard, using the expected duration of a mining operation to calculate its benefit period is reasonable: it means that the cost of acquiring mining rights or information attributable to a particular project should be capitalised and tax deductions for depreciation should be available over the life of the project, once it commences. If the project ceases, the capitalised costs must be written off because the benefit of the relevant mining rights or information has expired. According to accounting practice, capitalisation cannot be applied to exploration expenditure in circumstances where the mining entity does not have the legal right to explore a particular area or when it is not expected that the expenditure will be recouped by successfully developing a mining project or selling the rights or information for a profit.[4] Applying these accepted financial reporting standards in a new way—to intangible wasting assets like rights and information—will help ease the burden of tax administration and compliance.

The tax rules relevant to mining leases and information have evolved differently for different categories of taxpayers. At various points in time, there have different regimes for:

1. bona fide prospectors, referring to those who are not mining or petroleum operators but are primarily engaged in the business of prospecting for minerals or metals with a view to selling a mining lease upon successfully discovering resources or mining information through their prospecting activities;
2. mining operators who prospect, develop and produce mineral or metal resources; and
3. petroleum operators who are engaged in prospecting and extracting petroleum.

2 See Robin Boadway and Michael Keen, 'Theoretical Perspectives on Resource Tax Design' in Philip Daniel, Michael Keen and Charles McPherson (eds), *Taxation of Petroleum and Minerals: Principles, Problems and Practice* (Routledge, 2010) 13; Wayne Mayo, 'Combining Resource Rent and Income Taxation for Neutral Impact' (2019) 34(3) *Australian Tax Forum* 585. It is also helpful to understand the different stages of a resource project: see Scott Bryant and Rachel Willment, 'Lifecycle of a Resource Project' (Convention Paper, Taxation Institute of Australia, 26 November 2008).

3 Australian Accounting Standard, *Conceptual Framework for Financial Reporting* (AASB, 2019) [4.3].

4 Australian Accounting Standard, *Exploration for and Evaluation of Mineral Resources* (AASB 6, 2015).

Although qualitatively, petroleum operations involve broadly similar features to the first two groups, petroleum was dealt with under a separate regime until 1997. Similarly, for the first half of the 20th century, the taxation of mining leases was governed by a separate division in the tax legislation, although it appears possible that mining or petroleum enterprises could also have applied the mining or petroleum regime if the cost of a mining lease or information was not deductible under the division dealing with leases. This industry-specific regime allowed depreciation deductions for capital expenditure used for developing a mine or petroleum field, while also allowing immediate deductions for exploration expenditure. However, the purchaser of a mining lease or information was only allowed to deduct part of the acquisition cost, to the extent mutually agreed upon with the seller, by giving notice to the Commissioner of Taxation, and only up to the amount that the seller had not yet claimed as a deduction.

The depreciation regime was modified further in 2001, when bona fide prospectors became subject to tax on proceeds from selling mining leases. This allowed purchasers to deduct the actual expenditure incurred in acquiring a mining lease or information, irrespective of the seller's tax position. An inconsistency soon became apparent because purchasers were no longer required to characterise second-hand leases or information as capital expenditure but deduct the costs immediately under the exploration expenditure category even when mining leases and information were acquired for resources that were proven to exist, not merely speculative. In 2014, the depreciation rule was modified again to prescribe a deduction period of 15 years in respect of second-hand mining leases and information. However, the 15-year depreciation period is arbitrary.

2.1 Selling mining leases: bona fide prospectors and landholders

'Bona fide prospector' does not include casual or hobby explorers, nor does it apply to speculators who make money by buying and selling leases on land containing deposits.[5] Those who engage in field work exploring and prospecting for metals or minerals as their primary business objective are regarded as an enterprise for tax purposes,[6] like any other taxpayer carrying on a business.[7] Their dealings with mining leases are paid little attention under the resource industry tax regime, provided their expenditure is expected to be recouped through selling, transferring or assigning mining leases.

Under the original 1915 federal income tax laws, bona fide prospectors were assessed on the proceeds from a mining lease[8] and allowed to deduct the amount of money spent (or, prior to 1918, the sinking fund required to replace the money spent) to acquire the lease, for the duration of the lease period, if the Commissioner of Taxation allowed it.[9] Generally, this was in respect of expenditure incurred to produce income. However, from

5 In *Thomson v FCT* (1923) 33 CLR 73, a taxpayer who procured a mining lease for the purpose of selling it for a profit was not regarded as a bona fide prospector but merely a speculator.

6 'Exploration and prospecting' take their ordinary meaning. For example, in *Henderson v FCT* (1943) 68 CLR 29, testing mine dumps was considered prospecting. A company that carries on commercial activities can be considered as a bona fide prospector as long as a major part of its business is prospecting: see *Biggs v FCT* (1975) 5 ATR 505; cf. *Case 33/96* (1996) 32 ATR 1288.

7 Accordingly, immediate deductions were allowed for revenue outgoings under s 51(1) of the *Income Tax Assessment Act 1936*: see, eg, *FCT v Ampol Exploration Ltd* (1986) 13 FCR 545 (fees paid for a petroleum search). For further discussion, see Harry M Rigney, 'Petroleum Exploration: The Taxation Environment' (1995) 109(2) *Australian Banker: Journal of the Australian Institute of Bankers* 84.

8 *Income Tax Assessment Act 1915* s 14(d). See subsequent iterations in *Income Tax Assessment Act 1922* s 16(d); *Income Tax Assessment Act 1936* s 84.

9 *Income Tax Assessment Act 1915* s 20(i). See subsequent iterations in *Income Tax Regulations 1915* s 29, Sch Table I; *Income Tax Assessment Act 1922* s 25(i); *Income Tax Assessment Act 1936* s 85.

very early on, to encourage exploration activities and the sustainability of the industry, the government provided various tax exemptions for proceeds from selling, transferring or assigning mining leases.[10] The first exemption, which lasted for three years, between 1921 and 1924, applied to individual taxpayers prospecting for minerals.[11] Another exemption was introduced for gold prospectors in 1928, in response to slow rises in gold prices after World War I; the exemption was extended to companies in 1936, and in 1947, to individual and corporate taxpayers prospecting for other kinds of minerals and metals.[12] In 1954, the exemption was extended again, to ordinary lessors under the lease provisions.[13] It was intended to encourage landholders to grant or assign leases over land that potentially contained resources.[14] When the election option was selected, prospectors and mining operators were prevented from claiming deductions on lease transactions.[15] Neither party was assessed on any income they received, but they were not allowed to deduct expenses relating to the transaction.

Due to difficulty dealing with leases in some commercial contexts, the government decided to remove the lease division from the tax legislation.[16] In 1964, the lease division was abolished for all leases except primary production and mining leases.[17] In practice, this meant that a mining lease could be disregarded for tax purposes if the parties to the transaction agreed to do so. Other categories of lessors were assessed on lease premiums under a newly introduced lease assessment provision.[18] The tax exemption rule for mining leases continued until 1968.[19]

The changes to the lease division did not significantly affect bona fide prospectors of prescribed minerals and metals because their income from selling, transferring or assigning mining leases was exempt from tax, separately under a stand-alone provision. Like other taxpayers, they were allowed to deduct general costs, but the cost of acquiring a mining lease could not be deducted, since the lease division had ended. The income exemption rule ended in 1973.[20] However, four years later, it was reintroduced in the same terms

10 It did not extend to simply entering a royalty arrangement (see, eg, *Ivanac v DFCT* (1995) 60 FCR 417) but did include granting an option to transfer or assign a tenement (eg, *Cooke v DCT* (2000) 44 ATR 1118).

11 *Income Tax Assessment Act 1915* s 14(d), as amended by *Income Tax Assessment Act 1921* s 6. The provision was rewritten in *Income Tax Assessment Act 1922* s 16(d), which was repealed by *Income Tax Assessment Act 1924* s 4(k).

12 *Income Tax Assessment Act 1922* s 14(o), as inserted by *Income Tax Assessment Act 1928* s 5. See also Commonwealth, Parliamentary Debates, House of Representatives, 18 September 1928, 6784 (Green). The provision was rewritten in *Income Tax Assessment Act 1936* s 23(p).

13 *Income Tax and Social Services Contribution Assessment Act 1954* s 10, inserting *Income Tax Assessment Act 1936* s 88B.

14 Commonwealth, Parliamentary Debates, House of Representatives, 2 September 1954, 884 (Fadden).

15 *Income Tax Assessment Act 1936* s 88B.

16 For example, some hotel and motel business owners attempted to disguise the value of leases in the form of non-assessable goodwill when transferring their businesses along with leased premises. For further information, see Commonwealth Committee on Taxation (ES Spooner, chair), *Report on Leases* (Commonwealth of Australia, 1952); Commonwealth Committee on Taxation (SB Holder, acting chair), *Report on Leases* (Parliament of Australia, 1952); Commonwealth Committee on Taxation (GC Ligertwood, chair), *Report of the Commonwealth Committee on Taxation* (Commonwealth of Australia, 1961) [265].

17 *Income Tax and Social Services Contribution Assessment Act (No. 3) 1964* s 20, abolishing the lease division, except s 88A (primary production) and s 88B (mining leases) of the *Income Tax Assessment Act 1936*.

18 *Income Tax and Social Services Contribution Assessment Act (No. 3) 1964* s 9; *Income Tax Assessment Act 1936* s 26AB.

19 *Income Tax Assessment Act (No. 2) 1968* s 16, amending s 88B of the *Income Tax Assessment Act 1936* to give effect to the termination of election.

20 *Income Tax Assessment Act (No. 5) 1973* s 4(2), repealing s 23(p) of the *Income Tax Assessment Act 1936*.

and it continued until 2001.[21] The effect of exempting income from selling or transferring mining leases was most significant for the purchaser, especially after the lease division was abolished. As will be explained below, the acquisition cost of a mining lease was not fully deductible for the mining operator under the mining regime, only up to the amount that the vendor had not yet claimed as a deduction. In effect, the tax on profits generated by bona fide prospectors, whose income was exempt from tax in respect of discovery sites, was passed on to the mining operators who would eventually generate income from selling the resources. While mining operators were entitled to some deductions by mutual consent with vendor prospectors and were required to give notice of these agreed deductions to the Commissioner of Taxation, bona fide prospectors had no incentive to facilitate this process, which meant vendors' profits were often overstated for tax purposes.[22] Similarly, mining profits would likely be overtaxed if a mining enterprise could not reach an agreement with a lessor (who did not pay tax on lease premiums) concerning deductions.

Tax for bona fide prospectors changed significantly after the government's Review of Business Taxation—chaired by John Ralph and commonly known as the Ralph Review—released its report in 1999. Relying on concepts adopted from accounting, the Ralph Review did not consider it justified that mining operators acquiring leases could only deduct costs up to the amount that the seller could transfer.[23] It recommended allowing deductions for the full purchase price of mining leases and information and suggested that bona fide prospectors' income from mining leases become tax assessable. In 2001, these recommendations were enacted as legislation.[24] Consequently, mining operators were allowed to deduct the full cost of mining leases and information for the expected duration of their operations. While engaged in exploration, bona fide prospectors were allowed to deduct the cost of a mining lease immediately as exploration expenditure if the lease was first used for exploration purposes.[25] In other words, bona fide prospectors carrying on business with a view to deriving income from selling, transferring or assigning mining leases could carry their tax losses forward until they successfully discovered deposits that produced a profit.

2.2 Prospecting, developing and producing minerals and metals

As mentioned earlier, until 1964, the main rules for dealing with mining leases were in the lease division of the tax legislation.[26] The rules allowed mining operators to deduct

21 *Income Tax Assessment Amendment Act (No. 3) 1977* s 3, inserting *Income Tax Assessment Act 1936* s 23(pa). This was replaced by *Income Tax Assessment Act 1997* subdiv 330-B. See also ATO, *Income Tax: Exemption of Income Derived by Bona Fide Prospectors*, TR 92/19, 1992.

22 The Taxation Review Committee (KW Asprey, chair) noted this practice in its *Full Report* (Commonwealth of Australia, 1975) at [19.43] ('Asprey Committee Report').

23 Review of Business Taxation (JT Ralph, chair), *A Tax System Redesigned: More Certain, Equitable and Durable* (Commonwealth of Australia, July 1999) [242], 327–8, particularly Recommendations 8.15–8.16 ('Ralph Review Report'). Previously, the Asprey Committee Report (n 22) (at [19.46]) had also suggested full tax assessment for prospectors. The government's responses to the Ralph Review Report are summarised in Alice McCleary, 'Overview of the Review of Business Taxes' (Convention Paper, Taxation Institute of Australia, March 2000).

24 *New Business Tax System (Capital Allowances – Transitional and Consequential) Act 2001* ss 197, 331, which repealed div 330 and inserted s 15-40 in the *Income Tax Assessment Act 1997*.

25 *Income Tax Assessment Act 1997* subdiv 40-H.

26 Case law in this area is limited. However, a report by the Royal Commission on Taxation (W Kerr, chair) mentioned leases in the context of mining operation in its *Third Report* dated 4 August 1922 at [520] ('Kerr Royal Commission Report'). The explanatory memorandum for the 1936 Bill (at 88 n(c)) notes that the income exemption provision was deliberately positioned outside the lease division (div 4). Division 4 consolidated the tax rules governing leases in the previous tax legislation, with the term 'lease' defined coherently to apply to lessors and lessees (see *Income Tax Assessment Act 1936*, s 83).

the cost of acquiring a mining lease for the unexpired term of the lease.[27] Between 1954 and 1968, if the lessor agreed not to apply the lease division, the mining operator could not deduct the cost of acquiring the lease.[28] From 1968, the mining regime provided an alternative mechanism for deducting costs related to acquiring mining leases. This can be understood with the historical background of the deduction rules for mining leases and mining or prospecting information, which were, explicitly, deductible items under the mining regime at the time.

The original 1915 federal income tax legislation contained a separate regime for mineral and metal mining.[29] It allowed deductions for capital expenditure incurred for plant and developing a mining property, for the estimated number of years of the mining operation.[30] Alternatively, from 1918, taxpayers could deduct some of the income they had used for plant or development, but this was not suitable for taxpayers in a spending stage, as tax losses could only be carried forward for four years.[31] When the income exemption rule was extended to bona fide prospectors of various minerals and metals in 1947, a new deduction rule was also added to the mining regime. It allowed immediate deductions for exploration expenditure on mining tenures to recognise the fact that exploration and prospecting were necessary parts of a mining operator's enterprise.[32] If a mining enterprise had no profits against which to offset immediate deductions for exploration expenditure, their unclaimed deduction was included in the capital expenditure for developing their mining property the next tax year, which could be deducted for the number of years the current or future mining operations related to that project area were expected to continue.[33] Any tax losses due to unprofitable mining operations could be offset against other income, not limited to mining income.[34] In 1951, the maximum duration of mining operations was deemed to be 25 years, reflecting the general timeframe within which mineral deposits are exhausted.[35]

27 *Income Tax Assessment Act 1915* s 14(d); *Income Tax Assessment Act 1922* s 16(d); *Income Tax Assessment Act 1936* s 84.

28 *Income Tax Assessment Act 1936* s 88B.

29 *Income Tax Assessment Act 1915* s 17. This was replaced by *Income Tax Assessment Act 1922* s 22; *Income Tax Assessment Act 1936* div 10 (which initially contained ss 122–4). Coal mining was excluded from the scope of the provision until 1951: see *Income Tax and Social Services Contribution Assessment Act 1951* s 16.

30 A 'mining property' refers to mineral or metal deposits: see *Kerr Royal Commission Report*, (n 26) [523]; *Asprey Committee Report* (n 22) [19.12]. See also JAL Gunn, *Australian Income Tax Law and Practice: Volume 5* (Butterworths, 11th ed, 1975) [122/01].

31 See *Income Tax Assessment Act 1915* s 17, as amended by *Income Tax Assessment Act 1918* s 12. This was replaced by *Income Tax Assessment Act 1922* s 22(c) and *Income Tax Assessment Act 1936* s 124 and ultimately, removed by the restructure of the mining regime under *Income Tax Assessment Act (No. 2) 1968*. The historic development of the mining regime was surveyed in JA Timbs, 'Historical Survey of the Mining Provisions of Commonwealth Income Tax Legislation' in the *Asprey Committee Report* (n 22) 164; CT Gibbons, 'Recent Development in Taxation of the Mining and Petroleum Industries' (1977) 1(1) *Australian Mining and Petroleum Law Journal* 123.

32 *Income Tax Assessment Act 1947* s 20, inserting *Income Tax Assessment Act 1936* s 123AA.

33 *Income Tax Assessment Act 1947* s 19, replacing *Income Tax Assessment Act 1936* s 122. Previously, capital expenditure was deductible for the number of years mining operations had been underway. However, it became apparent that this approach was ineffective because tax losses were allowed to be carried forward for only four years. The new section included deductions for the number of years remaining in a mining operation. See Explanatory Memorandum, Income Tax Assessment Bill 1947, cl 19.

34 Offsetting tax losses against income from non-mining income was allowed from 1928 onwards: see *Income Tax Assessment Act 1928* s 10.

35 Commonwealth, *Parliamentary Debates*, Senate, 27 November 1951, 2719–22 (Spooner).

In 1968, the mining regime was modified in response to ambiguity in the deduction categories for capital expenditure.[36] Mining and prospecting rights and information were explicitly listed as deductible items.[37] The acquisition cost of mining or prospecting rights was deductible up to the amount that the vendor had not yet claimed as a deduction, which was required to be specified in a notice to the Commissioner of Taxation.[38] In this regard, mining and prospecting information was treated the same way as mining and prosecting rights, and value could be shifted between them.[39] Bona fide prospectors, whose profits from selling, transferring or assigning mining leases was tax exempt, could also transfer exploration expenditure. Unlike capital expenditure, exploration expenditure was not itemised.[40] However, this time, the option to claim immediate deductions on income used for developing a mining property was removed from the rules.

The mining regime underwent several more changes in the next few decades, most notably, increased concessions through tax deductions. Previously, tax concessions had generally been provided by exempting certain types of income. For example, from 1924, income relating to gold mining operations was exempt from tax.[41] From 1955, income from uranium mining was exempt.[42] In 1942, when there was a shortage in mineral production due to World War II, mining profits were also made partially exempt from tax.[43] Over time, this temporary exemption was extended to encourage exploration and development of base metal and rare mineral resources.[44] The uranium income exemption rule was removed in

36 The landmark case on this issue was *FCT v Broken Hill Pty Co Ltd* (1969) 120 CLR 240, which dealt with various expenses. The acquisition cost for the right to explore, for example, was not a capital expenditure because exploration was preliminary to mining operations. See also *Mount Isa Mines Ltd v FCT* (1954) 92 CLR 483, in which the court said 'development' in the phrase 'development of the mining property' did not embrace prospective work. Preparatory expenditure for mining operations included payment to a leaseholder for inducing the surrender of their lease with a view to obtaining a mining lease from the government, compensation paid for disturbing the surface of the land and feasibility study expenditure: see *Utah Development Co v FCT* (1975) 5 ATR 334; *Griffin Coal Mining Co Ltd v FCT* (1990) 21 ATR 819; Andrew Nelson, Basil Mistilis and Shigeaki Inoue, 'Exploration Issues' (Conference Paper, Taxation Institute of Australia, 17 October 2012).

37 *Income Tax Assessment Act (No. 2) 1968* s 17, replacing *Income Tax Assessment Act 1936* s 122A. Mining and prospecting rights and information were mentioned in s 122A(1)(d)), which is equivalent to the current ss 995-1(1), 40-730(8), *Income Tax Assessment Act 1997*.

38 *Income Tax Assessment Act 1936* s 122B. See the notice requirement for deductions in *QCT Resources Ltd v FCT* (1997) 36 ATR 184 (reimbursement to the vendor for removing overburdened work-in-progress at a strip mine); *Cyprus Mines Corporation v FCT* (1978) 36 FLR 295 (no consent obtained from the vendor who carried on mining operations). A balancing adjustment was allowed upon abandonment of a tenement: see *Esso Australia Resources Ltd v FCT* (1998) 84 FCR 541 (technical and professional services, options, rentals, legal fees, stamp duties and licence fees).

39 Chu and Lonergan claimed the market value of information also depended on the market value of other critical mining assets such as mining rights, plant and equipment: Hung Chu and Wayne Lonergan, 'The Value of Mining Information and Its Tax Implications' (2013) 48(2) *Taxation in Australia* 96. See also the *Asprey Committee Report* (n 22) [19.45].

40 *Income Tax Assessment Act 1936* s 122J. Bona fide prospectors were allowed to immediately deduct exploration expenditure under the general deduction rule for revenue outgoings: *Esso Australia Resources Ltd v FCT* (1998) 84 FCR 541. Further, see ATO, *Income Tax: Mining Exploration and Prospecting Expenditure*, IT 2642, 1991, [6].

41 *Income Tax Assessment Act 1922* s 14(1)(la) was inserted by *Income Tax Assessment Act 1924* s 3(b) and replaced by *Income Tax Assessment Act 1936* ss 23(o), 23C (for gold miners and eligible gold marketing companies, respectively). See *Parker v CT* (1953) 90 CLR 489.

42 Under s 23D of the *Income Tax Assessment Act 1936*, as inserted by the *Income Tax and Social Services Contribution Assessment Act 1955* s 4, exempt income must be derived by sale to or to a purchaser approved by the Commonwealth of Australia.

43 *Income Tax Assessment Act 1936* s 23A, as inserted by *Income Tax Assessment Act (No. 2) 1942* s 6.

44 *Income Tax and Social Services Contribution Assessment Act (No. 2) 1953* s 4 substituted s 23A of the *Income Tax Assessment Act 1936*. See *Mount Isa Mines Ltd v FCT* (1976) 6 ATR 334; *Ravenshoe Tin Dredging Ltd v FCT* (1966) 116 CLR 81.

1969 and mining profits from selling uranium became subject to the partial exemption rule,[45] which was also abolished in 1974.[46]

Following these changes to the tax exemption rules, amendments were also made to the deduction rules under the mining regime. The first, in 1974, allowed deferral of exploration expenditure to the next tax year, or later years, until net mining income was available after deducting capital expenditure.[47] The second change came two years later, permitting capital expenditure deductions for mining operations over five years, a significant reduction from the previous maximum of 25 years.[48] In the early 1980s, it was increased to six years,[49] then to 10 years.[50] From 1984, exploration expenditure was allowed to be offset against income from any source.[51] The tax exemption for gold mining income was eventually abolished in 1988,[52] in response to the government's May 1988 economic statement. In this statement, it was argued that the gold mining industry was largely owned by foreign corporations and exempting them from tax, while Australian-owned mining operations were being fully taxed on their profits, only diminished Australia's economic returns.[53]

In 1990, the tax regime for mining was extended further to include quarrying operations.[54] Previously, coal mining had been excluded due to coal deposits being close to the surface of land[55] and, similarly, questions being raised about whether the mining regime applied to open pit and surface mining.[56] Adding quarrying operations to the regime removed this ambiguity, albeit in a slightly modified manner. Unlike other mining operations, capital expenditure for quarries was deductible for the estimated number of years of operation or 20 years (instead of 10 years), whichever was less, on the presumption that quarries would last longer than mines and were situated close to urban areas. In the same year, one more change was made to the deduction rules to allow an immediate deduction for regional exploration expenditure in the grassroots stage, removing the requirement to explore only on existing mining tenures.[57]

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45 *Income Tax and Social Services Contribution Assessment Act (No. 2) 1961* s 2 amended s 23D of the *Income Tax Assessment Act 1936*. The provision was repealed by *Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006* s 47.

46 *Income Tax Assessment Act (No. 2) 1974* s 5, repealing *Income Tax Assessment Act 1936* s 23A.

47 *Income Tax Assessment Act (No. 2) 1974* s 28, amending *Income Tax Assessment Act 1936* s 122J.

48 *Income Tax Assessment Amendment Act (No. 3) 1976* s 14, inserting *Income Tax Assessment Act 1936* s 122DB, which applied to expenditure incurred between 18 August 1976 and 30 April 1981.

49 *Income Tax (Assessment and Rates) Amendment Act 1981* s 13, inserting *Income Tax Assessment Act 1936* s 122DD, which applied to expenditure incurred between 1 May 1981 and 18 August 1981.

50 *Income Tax Laws Amendment Act (No. 3) 1981* s 14, inserting *Income Tax Assessment Act 1936* s 122DF, which applied to expenditure incurred from 19 August 1981 onwards. Section 122DG was inserted (by *Income Tax Assessment Amendment Act 1983* s 27) to fix the technical deficiency in the 10-year deduction rule.

51 *Income Tax Assessment Amendment Act (No. 4) 1984* s 16, amending *Income Tax Assessment Act 1936* s 122J.

52 *Taxation Laws Amendment Act (No. 5) 1988* ss 9(b), 10, inserting the words 'subject to Division 16' in ss 23(o), 23C of the *Income Tax Assessment Act 1936.* Division 16, which was also inserted by this Act, gave effect to the termination of the exemption for gold mining income from 1 January 1991.

53 Paul Keating (Treasurer), *Economic Statement May 1988* (Parliament of Australia, 25 May 1988) 85–6.

54 *Taxation Laws Amendment Act (No. 2) 1990* s 22, which inserted subdiv 10-B into Pt III of the *Income Tax Assessment Act 1936*.

55 The exclusion was lifted by *Income Tax and Social Services Contribution Assessment Act 1951* s 16. See n 29 and accompanying text.

56 See, eg, *NSW Associated Blue-Metal Quarries Ltd v FCT* (1956) 94 CLR 509; *North Australian Cement Ltd v FCT* (1969) 119 CLR 353; cf. *North Australian Cement Ltd v FCT* (1989) 20 ATR 1058. See also *ICI Australia Ltd v FCT* (1972) 127 CLR 529 (pumping brine from underground was characterised as mining operations).

57 *Taxation Laws Amendment Act (No. 3) 1991* s 43, amending *Income Tax Assessment Act 1936* s 122J. See also Matthew Popham, 'The Income Tax Considerations Faced by Junior Explorers' (Seminar Paper, Tax Institute of Australia, 29 February 2012; 18 September 2012).

By the mid-1990s, after being heavily modified over the previous 60 years, the *Income Tax Assessment Act 1936* was rewritten to a large extent in 1997. The mining and quarrying regime was incorporated into the new version of the Act.[58] The main aim of the rewrite was to improve readability. Accordingly, while the content of the new mining and quarrying provisions did not change substantially, they were restructured. The rules were rearranged to reflect the different stages of mining and quarrying operations. For example, subdivision 330-A applied to the exploration stage and allowed taxpayers to claim immediate deductions for exploration expenditure including mining, quarrying or prospecting rights acquired from a government authority. Subdivision 330-C applied to the development and production stage and allowed taxpayers to deduct capital expenditure relating to a specific mining property, for up to 10 years for mining operations or 20 years for quarrying operations. Under subdivision 330-C, the amount the purchaser could deduct for second-hand rights or information was limited to what the vendor had not yet claimed as a deduction and had agreed to transfer to the purchaser (under subdivision 330-B).

As noted earlier, the rule exempting bona fide prospectors' mining lease income from tax was abolished in 2001. Relying on standard accounting practice concerning sunk costs, and as a matter of practicality, the 1999 Ralph Review had recommended that immediate deductions for exploration expenditure continue.[59] However, this caused serious inconsistencies in the way mining assets and assets in other industries were taxed.[60] After the Ralph Review, in 2001, the mining regime was dissolved and the tax rules relating to mining and quarrying were moved to a different part of the Act, to consolidate the various depreciation rules under the new uniform capital allowance system.[61] Mining, prospecting and quarrying rights and information were identified as separate 'depreciating assets',[62] deductible for the number of years mining or quarrying operations were expected to continue.[63] If mining operations were expected to last for 30 years, the deduction period was 30 years, unless the mining, quarrying or prospecting rights included a 21-year statutory limit that could not be extended or renewed, in which case the statutory period of 21 years applied.[64] Also, for both mining and quarrying operations, respectively, the old 10- and 20 year statutory limits on deductions were also removed to allow deductions on capital expenditure for the entire estimated life of a project.[65]

58 *Income Tax Assessment Act 1997* div 330.

59 *Ralph Review Report* (n 23) 167 [243], 327.

60 Ibid 326, in particular, Recommendation 8.15. Note that from 1988 onwards, plant and articles used in the resource industry were depreciable in the same manner as plant and articles in non-resource industries: *Taxation Laws Amendment Act (No. 4) 1988* ss 48–9, amending *Income Tax Assessment Act 1936* ss 122A, 124AA.

61 The *New Business Tax System (Capital Allowances) Act 2001* effectively repealed the mining regime in div 330 and repositioned the tax rules in various parts in div 40 of the *Income Tax Assessment Act 1997*.

62 *Income Tax Assessment Act 1997* ss 40-30(2)–(3), 40-290(5). A tenement could not be divided into the right to explore and the right to produce: *Mitsui and Co (Australia) Ltd v FCT* (2011) 86 ATR 258. In 2013, geothermal exploration rights and geothermal information were added to s 40-30(2)(ba)–(bb). Immediate deductions became available for geothermal exploration expenditure (s 40-730) and proceeds from selling geothermal exploration information were made exempt (s 15-40, which is still in effect). However, due to a change of government, the funding source for the new deduction mechanism, the mineral resources rent tax, ceased and the new deduction rules lasted for only two years. Since then, no further tax incentive has been provided for shifting from non-renewable energy to renewable energy. See *Tax Laws Amendment (2012 Measures No. 6) Act 2013*; *Minerals Resource Rent Tax Repeal and Other Measures Act 2014*.

63 *Income Tax Assessment Act 1997* ss 40-30(5), 40-105(4); Explanatory Memorandum, New Business Tax System (Capital Allowances) Bill 2001, [1.49], [1.114]–[1.117].

64 *Income Tax Assessment Act 1997* s 40-95(8).

65 *Income Tax Assessment Act 1997* subdiv 40-I (including 'mining capital expenditure', as detailed in s 40-860). See also Recommendation 8.9 in the *Ralph Review Report* (n 23); James Macky and Praneel Nand, 'Project Pools' (Conference Paper, Tax Institute of Australia, 15–17 October 2014).

A problem soon emerged with these changes. Previously, rights and information acquired on the market were treated as part of capital expenditure for developing a mining property. Deductions were limited to exploration expenditure that the vendor had *actually* expended,[66] but had not yet deducted, and agreed to transfer to the purchaser. However, the term 'depreciating assets' did not specifically refer to market transfer of mining, prospecting or quarrying rights or information. This encouraged some taxpayers to utilise the immediate deduction rule for exploration expenditure, which was allowed in the year in which the asset was first used, consistent with when depreciation began under the new uniform allowance regime (whereas previously, depreciation began when expenditure was incurred).[67]

In 2003, the depreciation period for mining, prospecting and quarrying rights and information was deemed to be the life of the relevant mine, petroleum field or quarry, whether it was proposed or already existed.[68] However, this was insufficient to prevent rights and information transferred on the market from being mischaracterised as exploration expenditure and eroding the tax base through unjustified deductions. To address the issue, the government amended the legislation again in 2014.[69] The amended rule, which is still in force today, made no substantial changes to the depreciation period for mining, prospecting and quarrying rights and information relating to a specific mine, petroleum field or quarry, but it allowed immediate deductions in only three circumstances: when rights or information were acquired from a government authority; when geophysical or geological data was acquired from another entity that specialised in mining, quarrying or prospecting information; or when the taxpayer had contributed to the cost of creating the mining, quarrying or prospecting information.[70] Other rights and information (first used for exploration) transferred on the market are typically deemed depreciable for 15 years.[71] A taxpayer could write off the book value before the 15-year period expired if exploration activities ceased but a clawback fee could be charged if exploration recommenced.[72] The following year, further provisions were introduced for interest realignment and 'farm-

66 See *Pratt Holdings Proprietary Ltd v FCT* (2013) 94 ATR 251.

67 *Income Tax Assessment Act 1997* subdiv 40-H.

68 Initially, s 40-95(7) of the *Income Tax Assessment Act 1936* was modified by *Tax Laws Amendment Act (No. 4) 2003* to insert items 11–13. To ensure depreciation was limited to straight line depreciation (i.e. not on a declining balance basis), the items were removed and s 40-95(7) was rewritten in s 40-95(10)-(11). See Explanatory Memorandum, Tax Laws Amendment (2007 Measures No. 2) Bill 2007, [1.20].

69 See Wayne Swan (Deputy Prime Minister and Treasurer) and Penny Wong (Minister), *Budget Measures 2012–13: Budget Paper No 2* (Commonwealth of Australia, 14 May 2013) 36–7; JB Hockey (Treasurer) and Arthur Sinodinos (Assistant Treasurer), 'Restoring Integrity in the Australian Tax System' (Joint Media Release, 6 November 2013); Explanatory Memorandum, Tax and Superannuation Laws Amendment (2014 Measures No. 3) Bill 2014, [1.6].

70 *Income Tax Assessment Act 1997* s 40-80(1)–(1AA); Explanatory Memorandum, Tax and Superannuation Laws Amendment (2014 Measures No. 3) Bill 2014, [1.9], [1.15].

71 *Tax and Superannuation Laws Amendment (2014 Measures No. 3) Act 2014* sch 1 ss 3, 5, replacing s 40-95(10) with s 40-95(10)–(10A); inserting s 40-95(12) of the *Income Tax Assessment Act 1997*. See also Claire Nicholson, 'Limiting the Immediate Tax Deduction for Exploration Expenditure' 33 *Australian Resources Energy Law Journal* 297. A shorter period than 15 years is only possible if a mine is proposed in relation to the rights or information.

72 *Income Tax Assessment Act 1997* s 40-295(1A)-(1B).

in, farm-out' arrangements to remove tax-induced penalties arising from the 15 year depreciation rule.[73]

As it currently stands, the new 15-year depreciation rule is not consistent with contemporary accounting standards and tax policy principles alike, particularly neutrality. Although it can be difficult to determine whether to capitalise costs, accounting practice requires that, consistent with the way tangible assets are treated for tax purposes, capitalisation should only occur when a future benefit is expected. In contrast, the cost of acquiring mining, prospecting or quarrying rights and information (for a project at the exploration stage) is deductible over 15 years even if the rights would last for five years or if they are being used in early-stage exploration activities. The start date for depreciation on these intangible assets—that is, when they are first used or held for use—is also inconsistent with other costs attributable to a resource project which begin depreciating from the year in which the project commences.[74] It seems using standard accounting practice to determine the deduction time of mining, prospecting or quarrying rights and information would be more logical and make tax simpler for taxpayers in the resource industry, who are predominately external financial reporting entities.

2.3 Petroleum exploration and extraction

The original mining regime did not apply to petroleum operations. A separate regime existed for petroleum prospecting and production, in parallel to the mining regime, between 1939 and 1997. The petroleum and mining industries share many features, including the significant sunk costs involved in exploration and prospecting and the capital outlays required for to produce resources commercially. In the 1930s, interest in petroleum production grew significantly around the world. Canada and New Zealand introduced tax concessions for the petroleum industry. Similarly, Australia introduced new tax incentives to encourage local petroleum operations, allowing taxpayers to claim immediate deductions on capital expenditure, offset against petroleum income,[75] which provided immediate cash flow and tax deferral benefits that could be reinvested. This mechanism lasted for nearly 35 years, until 1974, when it became apparent that highly profitable petroleum enterprises were paying relatively little tax and the petroleum regime was revised to align more closely with the mining regime.[76]

It appears that the old lease division in the tax legislation did not apply to the petroleum industry. Tax reforms undertaken in 1963 confirmed that costs associated with purchasing prospecting or mining rights and information were immediate deduction items under the

73 *Tax and Superannuation Laws Amendment (2015 Measures No. 2) Act 2015* sch 1. The previous administrative practice can be found in ATO, *Miscellaneous Taxes: Application of the Income Tax and GST Laws to Immediate Transfer Farm-Out Arrangements*, MT 2012/1, 2012; ATO, *Miscellaneous Taxes: Application of the Income Tax and GST Laws to Deferred Transfer Farm-Out Arrangements*, MT 2012/2, 2012. See also Ian Murray, 'The Tax Treatment of Farmouts: Do Rulings MT 2012/1 and MT 2012/2 Chart a Path to Revenue Nirvana or Hades?' (2013) 42(1) *Australian Tax Revenue* 5; Jonathon Leek and Peter Jarosek, 'The Resource Joint Venture' (Conference Paper, Tax Institute of Australia, 17–19 October 2012); David Young, 'Hot Tax Issues for Resource Companies Contract Rights and Agreements: Tips and Traps' (Convention Paper, Taxation Institute of Australia, 3 August 2006).

74 See *Income Tax Assessment Act 1997* s 40-860.

75 *Income Tax Assessment Act 1939* s 4, inserting *Income Tax Assessment Act 1936* s 123A; Commonwealth, *Parliamentary Debates*, House of Representatives, 21 September 1939, 962–4 (Spender).

76 Commonwealth, *Parliamentary Debates*, House of Representatives, 14 November 1974, 3551 (Crean).

petroleum regime.[77] As was the case under the mining regime, the purchaser of petroleum rights or information was entitled to deduct the acquisition cost only to the extent that the vendor had not already claimed a deduction for exploration expenditure, and the purchaser was required to notify the Commissioner of Taxation of the amount.[78]

Government policy concerning the petroleum industry shifted in the 1970s. In 1974, whereas capital expenditure relating to petroleum operations could previously be fully recouped before tax, it became deductible for the estimated number of years of the operations.[79] Prospecting expenditure became deductible immediately or, if there was insufficient income, expenditure could be deducted in a later year, when the petroleum operations became profitable. From 1976, capital expenditure could be deducted against income from any source, not just petroleum.[80] The depreciation period for capital expenditure on petroleum operations was also changed several times in the 1970s and early 1980s. Set at 25 years in 1974, it was changed to five years in 1976 to align with the mining regime,[81] then to six years for expenditure incurred between 1 May and 18 August 1981,[82] and 10 years for expenditure incurred from 19 August 1981 onwards.[83]

Under the new *Income Tax Assessment Act 1997*, the petroleum regime was merged with the mining regime. The rules discussed above concerning deductions for exploration expenditure, capital expenditure, prospecting rights and information for mining became applicable to petroleum, although unlike mining prospectors, petroleum prospectors' proceeds from selling, transferring or assigning rights have never been exempt from tax. Mining and prospecting rights and information were defined as depreciating assets under the uniform capital allowance regime in the new Act, which included rights and information used in petroleum operations.[84] Later, in 2003, the depreciation period for petroleum operations was deemed to be the life of an existing or proposed petroleum field.[85] However, an inconsistency arose with late stage prospecting rights and information transferred on the market for the value of existing resources, which were deductible immediately as exploration expenditure. In 2014, the depreciation period for rights and information transferred on the market (except for interest realignment and 'farm-in farm-out' arrangements) was set at 15 years if there was no specific petroleum field to which exploration and prospecting expenditure could be attributed.[86] To maintain consistency

77 *Income Tax and Social Services Contribution Assessment Act (No. 2) 1963* s 46, inserting *Income Tax Assessment Act 1936* div 10AA to provide a clear distinction between the petroleum related rules (div 10AA) and mineral or metal-related rules (div 10). Division 10AA, especially s 124DD(b), listed mining or prospecting rights and information as deductible capital expenditure items.

78 *Income Tax Assessment Act 1936* s 124DE. It was renumbered as s 124AB when the mining regime was modified by *Income Tax Assessment Act (No. 2) 1974*.

79 *Income Tax Assessment Act (No. 2) 1974* s 33, replacing *Income Tax Assessment Act 1936* div 10AA.

80 *Income Tax Assessment Amendment Act (No. 3) 1976* s 27, amending *Income Tax Assessment Act 1936* s 124AH.

81 *Income Tax Assessment Amendment Act (No. 3) 1976* s 25, inserting *Income Tax Assessment Act 1936* ss 124ADA–124ADB, which applied to expenditure incurred between 18 August 1976 and 30 April 1981.

82 *Income Tax Assessment Act 1936* ss 124ADC–124ADD, as inserted by *Income Tax (Assessment and Rates) Amendment Act 1981* s 19.

83 *Income Tax Assessment Act 1936* ss 124ADE–124ADF, as inserted by *Income Tax Laws Amendment Act (No. 3) 1981* s 26. Section 124ADG was inserted by *Income Tax Assessment Amendment Act 1983* s 36, to fix the technical deficiency in the 10-year deduction rule.

84 *Income Tax Assessment Act 1997* s 40-30(2)(a)-(b).

85 The amendment by *Tax Laws Amendment Act (No. 4) 2003*, as rewritten in s 40-95(10)-(11) of the *Income Tax Assessment Act 1997*. See n 68 and accompanying text.

86 *Income Tax Assessment Act 1997* ss 40-80(1)–(1AA), 40-295(1A)-(1B): see nn 70,72.

within the tax system, a balancing adjustment for costs previously written off was subject to the same clawback fee that applied to mining and quarrying rights and information.[87]

In retrospect, it was arbitrary to set the depreciation period for petroleum rights and information at 15 years, because mining or prospecting rights and information can legitimately be acquired for exploration activities. A neutral income tax policy, as reflected in standard accounting practice, requires costs to be capitalised based on the probability of future economic benefits. Sunk costs from exploration activities should be written off immediately, whereas capitalised costs for an expected future economic benefit should be deductible over time, from when that benefit begins to diminish.

3 Patents, registered designs and copyrights

Although in Australia's early history, intellectual property played a smaller role in generating business profits than it did in the latter half of the 20th century, it still played an important role. Even prior to federation, the colonies had intellectual property legislation in place. Commonwealth patents legislation was enacted in 1903, followed by copyright and trademarks laws in 1905. A law concerning registered designs was enacted in 1906. Shortly after World War II, in recognition of the important role research played in creating intellectual property that contributed to the nation's long-term economic growth, Australia introduced tax concessions to support scientific research activities.[88] However, the first cost recognition mechanism for depreciating intellectual property did not come until the 1950s.

In 1955, the Commonwealth Committee on Rates of Depreciation (AH Hulme, chair) was commissioned to investigate the depreciation deduction rules in the existing tax legislation. It found that the rules were limited to tangible assets, while patent rights and similar intangible rights, particularly registered designs and copyrights, which were akin to plant or articles, were not depreciable for tax purposes.[89] It also found that some taxpayers were paying five times more to deduct royalty payments immediately, when it would be more economical for them to enter into a licence arrangement or purchase the rights to intellectual property outright instead.[90] In 1956, the government adopted the Committee's recommendation to introduce new depreciation deductions, allowing deductions for the costs involved in securing patents, registered designs and copyrights on a straight line depreciation basis.[91] When the capital gains tax regime was introduced in 1986, the cost of acquiring other types of intangible assets like trademarks, plant breeders' rights, circuit layouts and non-wasting forms of intellectual property became recognised as capital losses upon expiry or early disposal.

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87 See n 73 and accompanying text.

88 It can be found in s 73A of the *Income Tax Assessment Act 1936*, as inserted by *Income Tax Assessment Act 1946* s 11. In 1986, a separate R&D regime was legislated by *Income Tax Assessment Amendment (Research and Development) Act 1986* s 7, inserting *Income Tax Assessment Act 1936* s 73B. From 2010, all R&D concessions are provided through tax credits: see *Tax Laws Amendment (Research and Development) Act 2011* and *Income Tax Rates Amendment (Research and Development) Act 2011*.

89 Commonwealth Committee on Rates of Depreciation (AS Hulme, chair), *Report of the Commonwealth Committee on Rates of Depreciation* (Commonwealth of Australia, 1955) 19–20.

90 Ibid [140].

91 *Income Tax and Social Services Contribution Assessment Act (No. 3) 1956* ss 9, 20, inserting s 68A (for outright deductions); div 10B (for depreciation deductions) into the *Income Tax Assessment Act 1936*.

The depreciation deduction rule for patents, copyrights and registered designs has evolved over time as a result of various reforms to the tax legislation and standardisation of the capital allowance system. While the tax laws concerning depreciable intellectual property were last reviewed in 2001,[92] ongoing changes have been made under intellectual property laws and the two systems sometimes conflict. For example, the effective life of a petty patent is six years under the tax laws, despite the fact that petty patents can no longer be granted in Australia.[93] Currently, the depreciation period for registered designs is 15 years under the tax laws whereas under the intellectual property laws, the statutory protection period is five years and can be extended to 10 years. For tax purposes, copyrights are depreciable for either the statutory protection period or 25 years, whichever is shorter. However, under intellectual property laws, the copyright protection period is the life of the author plus 70 years.[94] These inconsistencies are problematic but can be resolved simply by aligning depreciation periods to match the period for which the rights to depreciable intellectual property have been granted. It is important to note, as will be discussed in more detail later, that costs for developing or acquiring film copyrights should be treated differently because since 1978, the government has provided support to the Australian film industry through accelerated deductions and later, tax credits, referred to as 'tax offsets' in Australia.

3.1 Depreciation deductions for intellectual property

The original deduction rules applied to acquisition costs associated with registered patents, copyrights and designs recognised by statute, collectively referred to in the legislation as 'units of industrial property'.[95] The deduction rules also distinguished between three types of expenses: the initial costs incurred to establish ownership of intellectual property, such as registration and filing for extension; 'development costs', meaning any expenses involved in producing intellectual property that had not previously been deducted; and acquisition costs for patents, copyrights or registered designs already developed. An outright deduction was allowed for the first type of expense, despite the fact that it related to the acquisition of a long-term wasting asset.[96] However, this concession was small, given the relatively low costs involved in most cases. Capital expenses incurred in the course of creating intellectual property was depreciable over the legal life of the property, with a minimum annual write-off of either £50 (later, $100) or a pro rata amount based on the costs yet to be deducted.[97] Taxpayers who bought a second hand unit of industrial

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92 *New Business Tax System (Capital Allowances) Act 2001*.

93 See *Patents Amendment (Innovation Patents) Act 2000*.

94 *Copyright Act 1968* s 33.

95 *Income Tax Assessment Act 1936* div 10B, as inserted by *Income Tax and Social Services Contribution Assessment (No. 3) Act 1956*. Originally limited to rights granted under Australian laws, the rules relating to depreciable units of industrial property were expanded to include similar rights granted under foreign laws: see *Taxation Laws Amendment Act 1991* s 28, amending *Income Tax Assessment Act 1936* s 124K. In *Primary Health Care Ltd v CT* (2010) 186 FCR 301, copyrights recognised by common law did not include rights in patient records transferred as part of the acquisition of medical practices. See also *Krampel Newman Partners Pty Ltd v CT (No 2)* (2003) 126 FCR 561 (copyrights in cinematograph films). Different types of intellectual property are discussed in Sean Van Der Linden, 'Intangibles: Tax Tips and Traps' (Seminar Paper, Taxation of Institute of Australia, 10 October 2006); Anthony Bradica, 'Intellectual Property: Traps & Opportunities' (Convention Paper, Taxation Institute of Australia, 6 October 2006; Mark Macrae, 'Taxation of Virtual Property' (2008) 11(5) *Tax Specialist* 324 ('Taxation of Virtual Property').

96 *Income Tax Assessment Act 1936* s 68A, as inserted by *Income Tax and Social Services Contribution Assessment (No. 3) Act 1956* s 9. It was amended by *Income Tax Assessment Amendment Act (No. 3) 1984* s 20 to allow apportionment of expenditure partly incurred for income producing purposes.

97 *Income Tax Assessment Act 1936* s 124M(2).

property could also deduct the acquisition cost over the remaining statutory protection period or, in the case of a licence, the licence term.[98]

For vendors selling intellectual property rights, profits in excess of the depreciated book value were assessed using a balancing adjustment. The balancing adjustment rules in the intellectual property write-off regime were similar to the rules for depreciable tangible plant and equipment. Sales for less than the written-down value would give rise to a deductible loss, while excess depreciation, revealed by a sale for more than written-down value, was corrected by treating the excess as taxable income. In contrast, from 1985, the balancing adjustment rules for tangible assets corrected excess depreciation only up to the original acquisition cost and any profit greater than that remained untaxed until capital gains tax was required.[99]

The rules applied differently to 'partial disposals' of intellectual property, where taxpayers derived gains from intellectual property rights they still held.[100] Examples of partial disposals included licensing arrangements, compensation paid by the government for exercising its power to use a patented invention and any award of damages a taxpayer received for infringement of intellectual property rights. In effect, the proceeds from partial disposals were treated as balancing adjustments, offset against the value yet to be depreciated. Proceeds greater than the written down value of the property were an untaxed capital gain.[101] Proceeds were not treated as royalty substitutes and in the case of licensees, acquisition costs for intellectual property rights could be written off over the length of the licence term. Deemed consideration rules applied to non-arm's length transfers of intellectual property. In the case of a payment above market value, the transaction was deemed to take place at market value. A sale by the original owner was also deemed to be at market value. The sale value for a subsequent owner was deemed to be the original owner's costs.[102] If the property was sold in a non-arm's length transfer for less than market value, the Commissioner of Taxation had the power to adjust the transfer value.[103]

In the revised depreciation rules in the *Income Tax Assessment Act 1997*, the term 'industrial property' was renamed 'intellectual property'.[104] The effective life periods prescribed in the Act were also revised to align with intellectual property laws. The depreciation period for patents was updated from 16 years to 20 years and the period for petty patents from one year (which previously, could be extended by five years) to six years.[105] The effective life of registered designs was set at 15 years.[106] The effective life of copyrights was either 25 years or the remaining rights period, whichever was shorter. The Commissioner's discretion with respect to the effective life of copyrights, which had been inserted into the legislation in 1956, was removed due to uncertainty about the statutory protection period in cases of joint authorship.[107] Partial disposals were renamed 'partial realisations' and the written-

98 *Income Tax Assessment Act 1936* s 124L.
99 *Income Tax Assessment Act 1936* ss 124N, 124P.
100 The partial disposal rules were contained in *Income Tax Assessment Act 1936* ss 124V–124Y.
101 Disposal was at a zero value in *FCT v AusNet Transmission Group Pty Ltd* (2015) 231 FCR 59.
102 *Income Tax Assessment Act 1936* s 124R(1).
103 *Income Tax Assessment Act 1936* s 124R(2).
104 *Tax Law Improvement Act (No. 1) 1998* sch1, inserting into the *Income Tax Assessment Act 1997* div 383 (including a definition in s 995 1(1)). See also the capital gains tax treatment under the former s 104-205 (CGT event K1) of the *Income Tax Assessment Act 1997*.
105 *Income Tax Assessment Act 1997* s 373-35.
106 Ibid.
107 Ibid.

down balance available for future deductions was reduced, while proceeds greater than the total amount of expenditure became a taxable capital gain.[108]

The uniform capital allowance regime consolidated the depreciation rules for intellectual property, except for copyrights in films.[109] Again, the depreciation periods were reviewed. The period for an innovation patent was extended to eight years, while the periods for standard patents, petty patents, registered designs and licences that did not relate to copyrights remained unchanged (20 years, six years, 15 years and the licence term, respectively).[110] The approach to partial realisation was renamed 'splitting' and required a balancing adjustment in respect of the disposed part, with the remainder continuing to depreciate for the rest of the depreciation period.[111] It was not until 2001 that a further change to the depreciation rules allowed proceeds from selling intellectual property rights that exceeded the original acquisition cost to be treated as ordinary income under the balancing rules.[112]

Currently, the depreciation regime for intellectual property interacts with various other tax rules, such as the research and development regime, which provides tax credits for expenditure incurred in developing a unit of industrial property.[113] Once expenses are claimed under the tax credit scheme, they cannot be claimed again as deductions under the capital allowance system.[114] The cost of obtaining an intellectual property right relating to a project is deductible over the life of the project.[115] Alternatively, for small and medium-sized businesses, the cost of acquiring intellectual property rights may be used to reduce assessable income in the year in which the property is first used or added to a pool of deductions, as will be discussed in detail below in parts 5 and 6 of this article.[116] Under the current laws, no special immediate write-off rule exists for fees incurred to register or renew intellectual property rights.

108 For capital gains tax purposes, granting a licence may be taken as creating contractual or other rights under s 104-35 (CGT event D1) of the *Income Tax Assessment Act 1997* or as a cancellation, surrender or similar termination of ownership of an asset under s 104-25 (CGT event C2,which applies before CGT event D1 in the *Income Tax Assessment Act 1997*). Under s 115-25 of the Income Tax Assessment Act 1997, the partial exemption on the gain does not apply to the former but does apply to the latter. See also Taxation of Virtual Property (n 95); Daniel Sydes, 'Tax Consequences of Disposing of Intellectual Property' (2012) 15(4) *Tax Specialist* 196.

109 *New Business Tax System (Capital Allowances) Act 2001* sch 1, inserting *Income Tax Assessment Act 1997* s 40-30(2)(c). The definition of intellectual property is in s 995-1(1), *Income Tax Assessment Act 1997*.

110 *Income Tax Assessment Act 1997* s 40-95(7), as inserted by *New Business Tax System (Capital Allowances) Act 2001*.

111 *Income Tax Assessment Act 1997* ss 40-115, 40-295(3).

112 *New Business Tax System (Capital Allowances) Act 2001* sch 1, inserting *Income Tax Assessment Act 1997* s 40-285. This was recommended in the *Ralph Review Report* (n 23) 318–20, specifically, Recommendation 8.11.

113 See n 88. See further Andrew Clements, 'Income Tax Implications of Disposals of Intellectual Property' (1990) 1 *Australian Intellectual Property Journal* 36; Geoff Mann and Michelle Parsons, 'Taxation of Intellectual Property: A Summary of Australian Tax Issues' (2002) 8 *Asia-Pacific Tax Bulletin* 718. Generally, prospecting or mining operations are not considered core research and development activities: see *Income Tax Assessment Act 1997* s 355-25(2); Steve Elias and Aaron Ng, 'Resources 101 Day: The R&D Tax Incentive and Compliance for the Resources Sector' (Convention Paper, Taxation Institute of Australia, 18 October 2013).

114 *Income Tax Assessment Act 1997* s 355-715 (in div 355, providing refundable tax offsets for eligible taxpayers with a turnover of less than $20 million and non-refundable tax offsets for all other eligible taxpayers). See also Maria Lui and James Macky, 'Commercialising Intellectual Property – A Taxing Initiative?' (2002) 6(1) *Tax Specialist* 10 ('Commercialising Intellectual Property').

115 *Income Tax Assessment Act 1997* s 40-840(2).

116 *Income Tax Assessment Act 1997* subdiv 328-D, s 40-82.

In 2015, the government proposed that taxpayers be allowed to decide the appropriate depreciation period for their income-producing intellectual property rights.[117] However, the proposal did not pass in the Senate and never became law.[118] Depreciation periods have not been reviewed since 2001 and have become outdated, particularly in light of current intellectual property laws granting protection to registered designs for five years (which can be extended to 10 years) and copyrights for the life of an author plus 70 years, while petty patents are no longer granted in Australia. Now, the 2015 proposal to allow self-assessed effective life periods for intellectual property should be revisited or at least, the arbitrary depreciation periods set by the current legislation should be revised to match the statutory periods for which the rights have been granted.

3.2 Tax concessions for Australian film and television

After World War II, Australia's cultural focus shifted towards establishing a national identity distinct from the British Empire. In 1960, restrictions were imposed on broadcasting imported television content. Throughout the 1960s and 1970s, government policies and new government-funded institutions designed to promote local film and television content continued to evolve. For example, the Australian Film Development Corporation was created in the late 1960s, the Australian Film and Television School in 1973 and the Australian Film Commission in 1975. The tax system was also enlisted to support the Australian film and television industry.

3.2.1 1978–2001: subsidising local content

The first tax concession specifically for the film and television industry was introduced in 1978.[119] To receive it, taxpayers were required to make their film in Australia and have it certified by the Minister for Home Affairs and Environment as Australian content. Upon certification, film development costs were tax deductible over two years. Also, 50% of the production costs could be deducted each year, beginning when the film first produced income, instead of the 25-year period that applied to capitalised development costs for non-film copyrights under the industrial property depreciation regime. This initial tax concession was soon followed by an even more generous deduction rule in 1981, which was available to Australian tax residents bearing entrepreneurial risk for producing a feature film, documentary or television drama mini series.[120] The amount of capital expenditure that could be deducted for developing an eligible Australian film was increased to 150%, deductible in the year in which the film copyright was first used to produce income. Meanwhile, any proceeds from the sale or partial disposal of the rights in a film copyright was assessable income.[121] The assessment rule inserted into the tax legislation at this time applied to both the 1978 and the 1981 concessions for film development costs, irrespective of whether money received from a film project was income or capital in character. In effect,

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117 Scott Morrison (Treasurer), 'Tax and Business Incentives to Boost Economic Growth & Jobs' (Media Release, 7 December 2015). Subsequently, this proposal was included in the Treasury Laws Amendment (2017 Enterprises Incentives No 1) Bill 2017 sch 2.

118 See the Schedule of the Amendment made by the Senate on 5 December 2018 in Treasury Law Amendment (2017 Enterprise Incentives No 1) Bill 2017. This bill was passed by the House of Representatives: see Commonwealth, *Parliamentary Debates*, House of Representatives, 12 December 2019, 12967–8.

119 *Income Tax Assessment Amendment Act (No. 4) 1978* ss 13–28, amending *Income Tax Assessment Act 1936* div 10B.

120 *Income Tax Assessment Amendment Act 1981* s 13, inserting *Income Tax Assessment Act 1936* div 10BA. Investment costs were deductible if they were subsequently spent on producing a film (*FCT v Faywin Investments Pty Ltd* (1990) 22 FCR 461) but marketing activities were not considered part of film production (*Gross v FCT* (1999) 85 FCR 270).

121 *Income Tax Assessment Amendment Act 1981* s 4, inserting *Income Tax Assessment Act 1936* s 26AG.

this meant a tax on capital gains, even before the new capital gains tax regime was added to the legislation.[122] The overall tax effect was exceedingly favourable to the industry. At that time, the top marginal tax rate of 60% applied to taxable income exceeding $34,478 (for the 1980-81 income year). It means that individual taxpayers could receive an immediate tax refund of $90 on the $100 invested in a film, whereas any profits were half exempt. There was no incentive to produce a good film that would sell; the film could make a loss and the investor would still make a profit.

To increase the financial incentive for making profitable films, 50% of the net assessable income derived from a film copyright transaction was exempt from tax, in addition to the 150% deduction rule.[123] In 1983, the 150% deduction rule was extended again to allow immediate deductions for capital expenditure if a film was expected to be completed and distributed within two years.[124] However, in 1984, the percentage of expenditure eligible for immediate deductions and net income exempt from tax was reduced to 33% and to 20% in 1985.[125] From 1988, deductions greater than actual expenditure and the exemption on net assessable income where no longer available.[126] Nonetheless, throughout the 1980s, the various tax incentives offered for eligible films were a great success in terms of encouraging private investment in the industry. While investment was worth $120 million in 1982, it had grown to over $180 million by the late 1980s[127] and the number of feature films produced per year in Australia increased from less than 20 to 40.[128]

3.2.2 2001 onwards: the shift towards foreign investment

In the 1990s, with growing multiculturalism and cross-border investment, policy perspectives began to shift. Although restrictions on international content had sheltered the Australian film industry, heavy industry regulation had impeded market competition, creativity and innovation. Meanwhile, Hollywood was dominating the global film market. Various countries competed to attract big budget American productions. For example, Canada and Ireland introduced new tax incentives for foreign film investment.[129] Similar measures were eventually introduced in Australia. In 2001, when the intellectual property depreciation rules were incorporated into the uniform capital allowance regime, the accelerated deduction rules for Australian films continued, after an industry review.[130] The following year, a new subsidy was introduced: a 12.5% return on film production expenditure of at least $15 million upon completion of the film. This was clearly aimed at foreign film investment, as most domestic production budgets were less than $6 million at

122 Film production subsidies generally preceded capital gains measures. See also *Income Tax Assessment Act 1936* pt III div 13; *Income Tax Assessment Act 1997* ss 104-205, 118-30.

123 *Income Tax Assessment Amendment Act 1981* s 3, inserting *Income Tax Assessment Act 1936* s 23H.

124 *Income Tax Assessment Amendment Act 1983* s 45, inserting *Income Tax Assessment Act 1936* ss 124ZADA–ADB.

125 *Income Tax Assessment Amendment Act 1984* s 4; *Taxation Laws Amendment Act (No. 3) 1985* s 22.

126 *Taxation Laws Amendment Act (No. 5) 1988* s 23, amending *Income Tax Assessment Act 1936* s 124ZAFA.

127 Braedon Clark, 'Using Tax Incentives to Encourage Investment in the Australian Film Industry' (1999) 9(1) *Revenue Law Journal* 58 ('Using Tax Incentives'). See also Kay Daniels, 'Balancing Objectives: The Role of the Commonwealth in Cultural Development' (1997) 8(1) *Culture and Policy* 5.

128 Ibid.

129 Ibid.

130 See David Gonski, *Review of Commonwealth Assistance to the Film Industry* (Commonwealth Department of Communications and the Arts, January 1997).

the time.[131] However, Australia's program to encourage foreign film investment was not a great success and did not achieve any substantial policy outcomes.[132]

The 2005 free trade agreement between Australia and the US was another significant event for the Australian film and television industry. It meant that regulatory restrictions, such as quotas for Australian content on free-to-air television, would no longer been tightened. The same year, film copyrights were included in the uniform capital allowance regime.[133] Unlike other copyrights, which were depreciable based on statutory periods, film copyrights were depreciable based on an effective life determined by the taxpayer. Film copyrights could also be depreciated on a declining balance basis, whereas other intellectual property was depreciable on a straight line basis.

Commonwealth tax concessions for Australian films were scaled back in 2007. However, as foreign investment opportunities grew, state governments began subsidising the industry and Commonwealth agencies sought to avoid dual subsidisation. Subsequently, the accelerated deduction rules for films were converted into three new types of mutually exclusive tax offsets.[134] The first, 'producer offsets', provided a 40% return on investment in a feature film production or a 20% return on investment for any other type of film. The second, 'location offsets', consolidated the subsidies available for large production companies and incentivised large scale film productions located in Australia by providing a 15% return on investment for any type of film. The third category, 'post, digital and visual effect offsets' ('PDV offsets') sought to attract post-production, digital and visual effects production to Australia by providing a 15% (or, from 1 July 2001, 30%) return on investment. From 10 May 2011, the subsidy level increased to 16.5% for location offsets and 30% for PDV offsets.[135] In 2017, producer offsets were extended to include costs associated with principal photography undertaken overseas.[136]

Currently, the expenditure categories used for calculating these tax offsets are still not deductible under the capital allowance regime.[137] The offsets, which promote foreign investment while attempting to protect the domestic industry, have also been criticised from a policy perspective.[138] Should they be withdrawn, adopting the neutral income

131 *Income Tax Assessment Act 1997* div 376, as inserted by *Taxation Laws Amendment (Film Incentives) Act 2002* and repealed by *Tax Laws Amendment (2007 Measures No. 5) Act 2007*. Australia's policy changes relating to the film industry are explained in Rachel Parker and Oleg Parenta, 'Explaining Contradictions in Film and Television Industry Policy: Ideas and Incremental Policy Change Through Layering and Drift' (2008) 30(5) *Media, Culture & Society* 609; Rachel Parker and Oleg Parenta, 'Multi-Level Order, Friction and Contradiction: The Evolution of Australian Film Industry Policy' (2009) 15(1) *International Journal of Cultural Policy* 91.

132 *Income Tax Assessment Act 1997* subdivs 375-G (special loss rules), 375-H (equity investor subsidies), as introduced by *Taxation Laws Amendment (Film Incentives) Act 2002* and repealed by *Tax Laws Amendment (2007 Measures No. 5) Act 2007*. See also *Using Tax Incentives* (n 127).

133 *Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Act 2005* sch 4, amending *Income Tax Assessment Act 1997* s 40-70(2). *Tax Laws Amendment (2007 Measures No. 5) Act 2007* repealed *Income Tax Assessment Act 1936* divs 10B–10BA.

134 *Tax Laws Amendment (2007 Measures No. 5) Act 2007*, inserting *Income Tax Assessment Act 1997* div 376. These changes were expected to produce an estimated $11 million reduction in tax expenditure for the one or two-year deduction provision and only a $3 million increase in the tax offset system: *Tax Expenditures Statement 2007* (Commonwealth of Australia, 2007); John Garden, 'Film, Arts and Culture' in Parliament of Australia, *Research Brief: Budget Review 2007-08* (Commonwealth of Australia, 2007) 92–4.

135 *Tax Laws Amendment (2011 Measures No 7) Act 2011* sch 9 items 1–4.

136 *Treasury Laws Amendment (Tax Integrity and Other Measures No. 2) Act 2018* sch 3 s 1, inserting *Income Tax Assessment Act 1997* s 376-170(3A).

137 *Income Tax Assessment Act 1997* s 40-45(6).

138 See, eg, Gene Tunny, 'Moochers Making Movies: Government Assistance to the Film Industry' (2013) 29(1) *Policy* 8; Commonwealth House of Representatives Standing Committee on Communications and the Arts, *Report on the Inquiry into the Australian Film and Television Industry* (Commonwealth of Australia, 2017).

tax approach would require that depreciation deductions be allowed for capitalised film development costs, for the length of the film copyright period. Straight line depreciation is likely to be appropriate for films available for online streaming, but the declining balance method may be allowed for films principally screened in theatres because they often lose much of their value after the first few weeks of screening.

4 In-house software

In a taxation ruling issued in 1979, the Commissioner of Taxation permitted taxpayers to claim immediate deductions for the cost of acquiring software (other than software integral to a computer system), whether off-the-shelf, custom-made or modified.[139] The rule remained in place for the next 19 years, as information technology developed rapidly and more businesses began using software for internal business purposes. The rule ended in 1998, when the Commissioner decided to remit the issue of distinguishing between current and capital expenses to the courts.[140] The same year, the government responded by providing new deductions for capital expenses relating to software, separate from the intellectual property depreciation rules,[141] which was legislated in 1999.[142] The new deduction rules applied to costs for developing or acquiring software used for internal purposes in running a business, ranging from simple word processing software to commercial websites[143] and complex enterprise solutions, collectively called 'in-house software' in the legislation.[144] This meant costs characterised as revenue outgoings were deductible immediately—for example, annual licence fees for third-party software and recurring monthly fees for software updates and technical support.[145] If characterised as capital expenses, they were deductible under the new software regime.[146]

The software regime has not changed significantly since it was introduced, other than certain changes made to deemed effective life periods. The rules operate in one of two ways: either depreciation can be claimed on individual units of software or, in the case of software development, expenditure can be pooled and depreciated as one unit. Currently,

139 In the Taxation Ruling IT 26 (*Computers – Depreciation, Investment Allowance*, withdrawn on 11 May 1998), software was treated as a revenue asset and hardware was treated as depreciable plant: see Harry Rigney, 'Deductions for Year 2000 Compliance Expenses' (1998) 10(5) *Journal of the Australian Institute of Bankers* 196.

140 Explanatory Memorandum, Taxation Laws Amendment (Software Depreciation) Bill 1995, [7].

141 Peter Costello (Treasurer), 'Taxation Treatment of Y2K Computer-related and Software Expenditures' (Press Release No 49, 12 May 1998).

142 *Taxation Laws Amendment (Software Depreciation) Act 1999* sch 1 s 14, inserting *Income Tax Assessment Act 1997* div 46. Capitalisation of in-house software is also allowed in the US and the UK: see Andrew Lymer et al, 'Taxing the Intangible: Overview of Global Approaches and a Review of Recent Policy Changes in the UK' (2003) 18 *Australian Tax Forum* 431.

143 However, domain names and content with a separate value to the owner (i.e. digital images) are distinct assets and not considered in-house software: see ATO, *Capital Allowances: Depreciating Asset – In-House Software*, ATO ID 2014/16, 2014, [43].

144 See the definition in *Income Tax Assessment Act 1997* s 995-1(1). Internal use includes when the taxpayer incurs expenditure on in-house software that will be used groupwide: see ibid. However, this does not apply to software developed and marketed for deriving income: see, eg, ATO, *Income Tax: Computer Software*, TR 93/12, 1993. Also, it does not apply to software that is trading stock: see Kate Walters, 'Potential Deductions Arising from Creating or Exploiting Intellectual Property' (2012) 15(4) *Tax Specialist* 186, 188–9.

145 ATO, *Capital Allowances: Cost – Enhancement and Support Fees for In-House Software*, ATO ID 2003/931, 2003; ATO, *Capital Allowances: Cost – Computer Software – Annual Licence Fees*, ATO ID 2010/14, 2003; Commercialising Intellectual Property (n 114).

146 See, eg, ATO, *Income Tax: Deductibility of Expenditure on a Commercial Website*, TR 2016/3, 2016, [12]–[13], [20]–[32].

the depreciation period is five years for individual software units, while expenditure pools for software are deductible at 30% per annum.[147] However, these patterns of deductions are unlikely to accurately reflect the actual benefit period of in-house software. One alternative is to make acquisition costs for software deductible outright under the small business concessions.

4.1 Short-term depreciation deductions for software

The software regime introduced in 1999 provided two options for claiming deductions.[148] The first, which borrowed several features from the tangible asset depreciation rules that applied to plant, allowed depreciation deductions for the cost of acquiring or developing individual units of software,[149] with outright deductions allowed up to $300.[150] However, depreciation only applied to 40% of the cost per annum, on a straight line basis.[151] The second option applied to development costs for in-house software including labour costs, software improvement costs and any commission paid to develop the software. Costs attributable to a software development project could be pooled and depreciated on a straight line at 40% per annum, from the year after the expenditure was incurred.[152] There was also a special rule allowing immediate deductions for 'Y2K' compliance costs,[153] which was a legislated version of the administrative practice that the Commissioner of Taxation had introduced in a ruling issued the year before.[154] However, these tax benefits were only temporary, until the Y2K issue was resolved.

Under the capital allowance regime, in-house software was defined as a depreciating asset separate from intellectual property, despite the fact that software-related transactions generally involve transfer or licensing of copyrights.[155] Aside from this, the optional pooling system that applied to software development costs was also revised under the uniform capital allowance regime to allow various expenditure incurred in the same year to be allocated into one pool.[156] It removed the difficulty involved in assigning costs related to multiple projects undertaken at the same time.[157] Other than these revisions made at the beginning of the uniform capital allowance regime, the software depreciation rules have remained relatively steady. The main changes have been to increase the deemed effective life periods. As part of measures included in the 2008 Budget, the depreciation period for

147 *Income Tax Assessment Act 1997* s 40-455.

148 *Taxation Laws Amendment (Software Depreciation) Act 1999* sch 1 s 14, inserting *Income Tax Assessment Act 1997* div 46.

149 *Income Tax Assessment Act 1997* s 46-30.

150 *Income Tax Assessment Act 1997* s 46-65.

151 *Income Tax Assessment Act 1997* ss 46-40, 46-45.

152 *Income Tax Assessment Act 1997* subdiv 46-D.

153 *Income Tax Assessment Act 1997* s 46-75.

154 ATO, *Income Tax: Deductibility of Year 2000 (Millennium Bug) Expenses*, TR 98/13, 1998.

155 *New Business Tax System (Capital Allowances) Act 2001* sch 1 s 1, inserting I*ncome Tax Assessment Act 1997* s 40-30(2)(d).

156 *Income Tax Assessment Act 1997* subdiv 40-E. The software pooling system does not have a clawback provision: see Tony Baxter, 'The Sting: Depreciation and Leasing' (Convention Paper, Taxation Institute of Australia, March 2000) 57-59; Tony Baxter, 'Tax Reform – Depreciation and Capital Allowances' (Seminar Paper, Taxation Institute of Australia, 20 April 2000) 24; Tony Baxter, 'Depreciation' (Seminar Paper, Taxation Institute of Australia, 20 April 2000; 6 July 2000) 24.

157 Explanatory Memorandum, New Business Tax System (Capital Allowances) Bill 2001, [4.30]; Geoff Mann, 'Australian Tax Issues for Development of Intellectual Property' (2005) 57(5) *Chartered Secretaries Australia Ltd* 296, 298; Teresa Dyson and Geoff Mann, 'Taxation Issues in the Development of Intellectual Property' (2007) 59(4) *Chartered Secretaries Australia Ltd* 236, 238.

units of in-house software increased from 2.5 years to four years.[158] In 2015, it increased again, from four years to five years.[159] The government claimed this change was made to better reflect the longevity of the benefits of internal software.[160] The annual depreciation rate for software development pools has also been increased from 40% to 30% per annum.[161]

Despite the recent changes, depreciation periods for in-house software remain relatively short, even with increased reliance on software in a wide range of business settings, including automated manufacturing and service industries. In these contexts, the use of software is akin to plant and equipment and the effective life of software should be calculated the same way. Although there may be greater uncertainty about how long software is expected to be used in a business, rational assessments can still be made and as with plant and equipment, balancing adjustments can provide write-offs for obsolete software.

4.2 Instant deductions for small to medium-sized businesses

Small business tax concessions have been changing continuously. The small business concessions introduced in response to the Ralph Review in 2001 apply not only to plant and equipment but also to in-house software.[162] At present, for those classified as small businesses for tax purposes, immediate deductions are allowed for assets costing less than $150,000, due to expire on 31 December 2020.[163] This concession is extended to any business with an aggregate annual turnover of less than $150 million, until 30 December 2020.[164] In addition, assets acquired between 6 October 2020 and 30 June 2022, businesses may be eligible to temporary full expensing.[165] To justify providing such significant tax concessions to the small and medium sized business sector, detailed evaluation of the economic benefits of the scheme is necessary. In doing so, the government would need to recognise in-house software as an important area of investment and evaluate it separately from the benefits of investment in capital intensive industries.

5 Media and telecommunications rights

When the capital gains tax regime was introduced in 1986, the cost base of an intangible wasting asset was either used to offset the proceeds, if any, from disposing of the asset or recognised as a capital loss upon expiry of the asset. This tax treatment was modified in 1999 for spectrum licences and the 'indefeasible right to use' (IRUs) international telecommunications submarine cable systems to allow immediate depreciation deductions that reduced assessable business income. Further, in 2001, the cost of datacasting transmitter licences recognised under the capital gains regime also became

158 *Tax Laws Amendment (Budget Measures) Act 2008* sch 2 s 1, amending table item 8 in s 40-95(7) of the *Income Tax Assessment Act 1997*.

159 *Tax and Superannuation Laws Amendment (2015 Measures No. 2) Act 2015* sch 2, amending *Income Tax Assessment Act 1997* s 40-95(7).

160 Commonwealth, *Parliamentary Debates*, Senate, 7 September 2015, 6048–9, 6054, 6056–7.

161 *Tax and Superannuation Laws Amendment (2015 Measures No. 2) Act 2015* sch 2, amending *Income Tax Assessment Act 1997* s 40-455.

162 *Income Tax Assessment Act 1997* div 152. See also *Ralph Review Report* (n 23) 581–4, particularly Recommendation 17.3.

163 *Income Tax Assessment Act 1997* s 328-180; *Income Tax (Transitional Provisions) Act 1997* s 328-180.

164 *Income Tax Assessment Act 1997* s 40-82.

165 See the eligibility criteria as enacted by *Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Act 2020*.

deductible under the uniform capital allowance regime, followed by domestic IRUs and telecommunications site access rights in 2005.

5.1 Spectrum and datacasting transmitter licences

Spectrum licences and datacasting transmitter licences are both granted for a limited time under the *Radiocommunications Act 1992*. A spectrum licence permits the holder to use radio frequencies in a designated geographic area. A datacasting transmitter licences permits the holder to provide services such as digital television and internet. New tax deductions were introduced in 1999, after the government introduced a market auctioning system for acquiring these licences. The depreciation mechanisms were considered necessary to avoid disadvantaging domestic bidders competing against foreign bidders who might be allowed to deduct their acquisition costs under foreign tax laws.[166] From 1999, the cost of acquiring a licences was depreciable for its statutory life span (generally 15 years) on a straight line basis.[167] The cost base for depreciation did not include auction application fees or penalties for withdrawing a bid, although they might be deductible outright.

The relevant regulatory body can vary the terms of a spectrum licence, which is reflected in the tax laws. For example, when a spectrum licence is split, the part that is disposed of is subject to a balancing adjustment, which results in either assessable income or a deduction. Any new part added to a current licence is considered a separate depreciating asset. The depreciation rules for spectrum licences in the uniform allowance regime have also been rewritten in a similar manner.[168] In 2001, datacasting transmitter licences were added to the depreciation regime as depreciating assets.[169] Statutory rights for this type of licence generally last for 10 years with a one-time option to renew for a further five years. The deemed effective life of a licence is 15 years, with a balancing adjustment available upon non-renewal, which is a logical approach as long as the renewal cost is assumed to be negligible.

5.2 International and domestic IRUs

IRUs are contractual agreements regarding the right to use specific telecommunications cables. International IRUs commonly last for several decades and the grantee commonly bears onerous responsibilities to maintain the cables. Tax deductions for costs incurred to acquire international IRUs were introduced in 1999, with the intention of reducing the cost burden for grantees who would otherwise recognise a capital loss upon expiry of the rights.[170] Depreciation was allowed for the duration of the contract on either a straight line or declining balance basis. Partial disposals of IRUs were treated in the same manner as partial spectrum licences, which meant the remaining portion could be written off using the depreciation method previously chosen, either straight line or declining balance. Any cost incurred to increase the capacity of the cables did not create a new asset but was added

166 Peter Costello (Treasurer), 'Taxation Treatment of Spectrum Licences' (Press Release No 26, 11 March 1998); Peter Costello (Treasurer), 'Taxation Treatment of Datacasting Transmitter Licences' (Media Release No 2, 24 January 2001).

167 *Taxation Laws Amendment Act (No. 6) 1999* sch 1, inserting *Income Tax Assessment Act 1997* div 380 (including the definition in s 995-1(1)).

168 *Income Tax Assessment Act 1997* ss 40-81(2)(c), 40-95(7), 40-115, 40-120, 40-190.

169 *New Business Tax System (Simplified Tax System) Act 2001* sch 1 s 1, replacing *Income Tax Assessment Act 1997* div 40 (particularly, s 40-95(7)).

170 *New Business Tax System (Capital Allowances) Act 1999* sch 4, inserting *Income Tax Assessment Act 1997* div 44.

to the written-down value of the asset. These rules were revised under the uniform capital allowance regime in 2001.[171]

In 2005, IRUs for domestic telecommunications cables were also added to the depreciation regime as depreciating assets, to align them with international IRUs.[172] Domestic IRUs do not last as long and are not as costly as international IRUs. However, the depreciation mechanism for domestic IRUs operate the same way, on either a straight line or declining balance basis for the duration of the contract.[173] The industry norm for claiming depreciation deductions on intangible wasting assets is to use straight line depreciation. Accordingly, the policy reason for permitting the declining balance option is unclear. Notably, both parties to a domestic IRU transaction are likely to be Australian taxpayers, using accelerated depreciation with respect to domestic cable assets.[174]

5.3 Telecommunications site access rights

When domestic IRUs came within the scope of the depreciation rules, telecommunications site access rights, as defined in the *Telecommunications Act 1997*, were also added as a category of depreciating assets.[175] Straight line depreciation was allowed for the term of the rights as a means to measure a neutral income tax base and to encourage sharing and more efficient use of telecommunications infrastructure.[176] Tax concessions for small and medium sized business can apply to telecommunications site access rights and domestic IRUs, whereas international IRUs are unlikely to be granted to or by a small business.[177] Notably, the special measures recently introduced in response to the COVID-19 crisis temporarily allow eligible businesses to deduct 50% of the acquisition cost in addition to the usual depreciation amount, if the assets were first used or installed and ready to use between 12 March 2020 and 30 June 2021.[178] Alternatively, assets may be eligible to temporary full expensing if the business turnover threshold, which can be as high as $5 billion, is met.[179]

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171 *New Business Tax System (Simplified Tax System) Act 2001* sch 1 s 1, replacing *Income Tax Assessment Act 1997* div 40 (especially, ss 40-81(2)(c), 40-95(7), 40-115, 40-120, 40-190.

172 *Tax Laws Amendment (2005 Measures No. 2) Act 2005* sch 3 items 2–3, replacing 'international telecommunications submarine' with 'telecommunications' in ss 40-95(9), 995-1(1) of the *Income Tax Assessment Act 1997*.

173 *Income Tax Assessment Act 1997* ss 40-70(2), 40-95. The acceleration rate applies to all assets eligible for accelerated depreciation under the uniform capital allowance regime. It was changed from 150% to 200% for assets acquired after 10 May 2006 (see *Tax Laws Amendment (Personal Tax Reduction and Improved Depreciation Arrangements) Act 2006* sch 5 s 1, inserting *Income Tax Assessment Act 1997* s 40-72.

174 In *FCT v Reef Networks Pty Ltd* (2004) 57 ATC 375, the owner claimed a deduction for depreciation of fibre optic cables.

175 *Tax Laws Amendment (2005 Measures No. 2) Act 2005* sch 3 items 8–11, adding s 40-30(2)(h) and the definition in s 995-1(1) of the *Income Tax Assessment Act 1997*.

176 See *Income Tax Assessment Act 1997* ss 40-70(2)(e), 40-95(7) table item 14; Explanatory Memorandum, Tax Laws Amendment (2005 Measures No. 2) Bill 2005, [3.5].

177 In addition to immediate deductions, under s 328-180 of the *Income Tax Assessment Act 1997*, small business taxpayers can also pool the cost of depreciating assets and depreciate the balance of the pool on a declining balance basis at an annual rate of 30% or 15% in the first year in which costs are allocated to the pool. Prior to 2012, this pooling system operated for a short-life asset pool (for assets lasting up to 25 years) and a long-life asset pool (for assets lasting 25 years or more).

178 *Coronavirus Economic Response Package Omnibus Act 2020* sch 2 s 7, inserting *Income Tax Assessment (Transitional Provisions) Act 1997* subdiv 40BA.

179 See *Coronavirus Economic Response Package Omnibus Act 2020*; *Treasury Laws Amendment (2020 Measures No. 3) Act 2020*; *Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Act 2020*.

6 Towards a universal regime for intangible wasting assets

Australia's income tax system provides a comprehensive depreciation regime for tangible wasting assets, which are categorised as 'depreciating assets'—that is, assets with a limited effective life that can reasonably be expected to decline in value over the time they are used.[180] Aside from the few exceptions discussed in the previous sections, intangible wasting assets are not classified as depreciating assets and are not covered by the depreciation regime.[181] It has been suggested that Australia implement a new depreciation regime that can be applied to all intangible wasting assets. After the Ralph Review recommended it in its 1999 report,[182] the government spent five years considering the issue as part of its tax law reform agenda.[183] Then, as announced in the 2005/06 Budget, the government withdrew its support for a new universal depreciation regime for intangible assets, on the grounds that it would add further complexity to the tax laws and possibly cause integrity issues.[184] However, on the contrary, the previous parts of this article have demonstrated that it would be feasible to implement a new, more wide-reaching depreciation regime that applies to a diverse range of intangible assets and allows for cost allocation over multiple years, even for more complex types of assets like mining rights and information, intellectual property and in-house software. In light of this, this part of the article reiterates that the cost allocation principles for intangible assets should be consistent with those applied to tangible assets. Three simple scenarios—acquiring limited-life assets, developing limited-life assets and acquiring assets that last for an uncertain period—are discussed to illustrate these principles.

6.1 Acquiring limited-life intangible assets

In general, the tax system permits cost allocation across the years in which a capital asset is used to produce income. It is relatively straightforward to apply this principle to assets that last for a limited time. For example, limited-life contractual rights can be depreciated over the duration of the contract. Limited-life statutory rights such as tenements, spectrum licences, datacasting transmitter licences, patents, copyrights, registered designs, plant breeders' rights, domains and circuit layouts, liquor licences and casino licences can be depreciated over their statutory rights period. To reflect this, the depreciation periods in the tax legislation should be set with the relevant statutory rights periods in mind but without directly importing provisions from other legislation into the tax laws, because statutory rights are constantly being revised. As noted earlier, the current depreciation periods for certain types of intellectual property are now outdated because the relevant intellectual property laws have changed. Depreciation should be applied systematically, on a straight line basis, unless the taxpayer can establish a pattern of an accelerated decline in value in earlier years for a particular intangible asset (eg, films displayed principally in theatres). Balancing adjustment should be available to recognise any gain or loss to the taxpayer, along with a market value substitution rule for distorted transfer values that do not conform to economic results. A policy review of the accelerated depreciation options currently

180 See *Income Tax Assessment Act 1997* s 40-30(1).

181 *Income Tax Assessment Act 1997* s 40-30(2).

182 *Ralph Review Report* (n 23) 369–406. See also Graeme S Cooper et al, *Income Taxation* (Thomson Reuters, 8th ed, 2017) 490.

183 Peter Costello (Treasurer), 'The New Business Tax System' (Press Release No 74, 11 November 1999); Peter Costello (Treasurer), 'Tax Value Method' (Press Release No 81, 7 August 2000).

184 Commonwealth of Australia, *Budget Measures 2005–2006* (Budget Paper No 2, 2005) 25.

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available for film copyrights and IRUs should be undertaken to determine whether they should continue.

One of the difficulties in the current system is the ambiguous distinction made in the courts between current and capital expenses. Regular or periodic payments made to acquire rights that last for a limited time may be characterised as current expenses, which are deductible immediately, whereas a lump sum paid to acquire the same rights may be characterised as a capital expense, which cannot be deducted immediately. In some cases, the courts have characterised the latter as being an immediately deductible outgoing,[185] which is clearly not justified from a tax policy perspective. Currently, the only other alternative is to recognise costs incurred in acquiring an asset or interest as capital losses under the capital gains regime. However, this is inappropriate in most cases because the tax liability is brought forward with no clear economic policy goal, while causing a tax-induced cash flow problem and potentially, depriving a business of immediate resources and opportunities. Similarly, as mentioned earlier, before depreciation deductions were introduced for patents, excessive, regular licence fees were often being paid. Establishing clear depreciation rules removed the tax disparity between licence acquisition and rent or royalty payments,[186] and between lump sum prepayments and periodic payments.[187] In the same way, introducing a new universal depreciation system for intangible assets would minimise incentives to misuse the revenue and capital characterisation rules and help restore the neutrality of the tax system.

6.2 Pooling development costs

While a taxpayer is creating or developing a new asset, costs must be capitalised. Once the asset is ready to be used, deductions for costs are allowed. When the value of the asset is depleted due to non-use or disposal, a write-off should be allowed for its remaining book value. This mechanism exists in the current system with respect to capital expenditure attributable to a project.[188] However, it does not currently apply to two categories of depreciable intangible assets: in-house software and in-house intellectual property. There are two main problems with the current system in this regard. First, the current depreciation period for in-house software has been set without regard to the diverse ways software is

185 See, eg, *BP Australia Ltd v FCT* (1965) 112 CLR 386 (exclusive sales ties). In contrast, after the full federal court characterised the lump sums paid to medical practitioners for exclusive service rights in *FCT v Healius Ltd* [2020] FCAFC 173, the taxpayer applied to the high court seeking special leave: Healius Limited, 'Update on Tax Case for Financial Years 2003 to 2007' (ASX Announcement, 6 November 2020). Note that granting a licence for confidential information (or know-how) may be recorded on a revenue account in a similar manner as income derived from rendering a service: see *Esso Australia Resources Ltd v FCT* (1998) 84 FCR 541.

186 For example, in *Inglewood and Districts Community Enterprises Ltd v FCT* (2011) 84 ATR 688, the franchise fee paid upon establishing a franchise agreement was a capital expense, whereas the franchise fee payable upon renewal of the agreement was immediately deductible on the ground that renewal fees were recurrent in nature. In *Cliffs International Inc v FCT* (1979) 142 CLR 140, the taxpayer acquired shares in a company through an earn-out arrangement and successfully argued that the payments were akin to rent or royalties as opposed to the purchase price of shares. For further discussion, see Sean Van Der Linden, 'Revenue Law Implications of Intangibles Know-How and Show-How Case Studies' (Convention Paper, Taxation Institute of Australia, 18 February 2005); Ramsey Andary and Michael Butler, 'In Practice: Franchise Fixings' (1996) 31(6) *Taxation in Australia* 300; Ramsey Andary and Michael Butler, 'Franchise Fixings: Part 1 – Structures and Fees/ Part 2 – Goodwill and Compliance' (1996) 31(6–7) *Taxation in Australia* 355; Chris Peadon, 'Withholding Tax on Partial Assignments of Copyright' (2011) 15(2) *Tax Specialist* 88; Paul McNab, 'Commentary: The Taxation of Intangibles' in Chris Evans and Richard Krever (eds), *Australian Business Tax Reform in Retrospect and Prospect* (Thomson Reuters, 2009) 396–7.

187 See *Origin Energy Ltd v FCT (No 2)* [2020] FCA 409.

188 Under subdiv 40-I of the *Income Tax Assessment Act 1997*, capital expenditure incurred for a project can be deducted over the life of a project. The current depreciation regime for mining, prospecting and quarrying rights and information is inconsistent with the treatment of other project costs for developing a mining property.

used in different business models and it is inherently difficult to assess the reasonableness of self-assessed effective life periods. That said, a policy review may be necessary regarding expensive infrastructural software that typically lasts far beyond the current depreciation period. The current start date for software depreciation pooling – when costs are incurred - is also questionable. Secondly, the existing depreciation regime no longer appears relevant to intellectual property development activities, due to the tax concessions available through the research and development tax offsets, filmmaking tax offsets and grants administered by Commonwealth agencies such as IP Australia and Screen Australia. An analysis of the tax offset systems is outside the scope of this article. However, if the depreciation regime is to be extended to include a broad range of self-developed intellectual property along with other intangible assets, it will be necessary to clarify the rules for capitalisation, including the start date for depreciation.

6.3 Intangible wasting assets with uncertain durations

Mining, prospecting and quarrying rights and information acquired on the market are depreciable for a statutory period of 15 years if they do not relate to a specific existing or proposed mine, petroleum field or quarry. This statutory period, based on the time reasonably required to establish a mine, petroleum field or quarry, was introduced in lieu of setting a clear capitalisation rule. It may be possible to follow the accounting practice to either capitalise expected future benefits or write off bona fide exploration expenditure, particularly in dealing with large financial reporting entities. The tax treatment of mining, prospecting and quarrying information is sound in that it is treated equivalent to mining, prospecting and quarrying rights. It recognises the value shifts that can occur between rights and information to rights.

In formulating a new universal depreciation rule, consideration should be given to flexibility and potential inconsistencies in naming intangible assets, which naturally can be difficult to define potential value shifting, as it was with mining, prospecting and quarrying information. Where appropriate, the system should account for intangible assets that waste in substance, however named, and exclude non-wasting intangible assets disguised in the form of wasting assets.

7 Conclusion

Australia has experimented with various depreciation rules for intangible assets including intangible assets created in-house and wasting assets with uncertain duration, such as mining, prospecting and quarrying information, in-house software and certain kinds of intellectual property. Similarly, the depreciation rules recently introduced for statutory licences and contractual arrangements in the media and telecommunications industries are an attempt to measure net income in a more economically neutral manner. These previous and existing rules can provide the building blocks for a new systematic cost allocation regime for intangible wasting assets. It would be reasonable to expand their scope in the coming years to include a wider range of industries.

A new universal depreciation system for intangible wasting assets can be built on the same core principles underlying the tangible asset depreciation regime, allocating costs to tax years in which assets are used to produce income. Depreciation for a broad range of assets, including leases and limited-life statutory or contractual rights, should be on a straight line, unless a taxpayer can establish that their assets decline in value in an accelerated

manner. In addition, a pooling mechanism can be adopted for costs involved in developing a future intangible asset, for which statutory depreciation rates may be considered for intangible assets that raise integrity concerns. If an intangible asset is linked to another tangible asset, the cost can be deducted in reference to the life of that tangible asset. For example, it is appropriate to depreciate mining information based on the life span of a mining property. Contrary to what the government claimed in 2005 when it reneged on its intention to implement a universal depreciation regime for intangible wasting assets, these reforms would simplify the tax system by harmonising cost recognition principles for all types of wasting assets. Importantly, it would also remove any tax bias that may exists against different business models (businesses driven by tangible and intangible assets would be treated the same way) and would help Australian taxpayers be more competitive in the global economy.