DEVELOPMENT EXPENDITURE

(Extract taken from Farm Accounting Made Easy, Module four, pages 17-22)

FA (Vol 10, Pgs 2-4)[p110]
FA (Vol 19, Pg 5)[p122]
FA (Vol 29, Pg 7)[p124]
FA (Vol 69, Pgs 4-5)[p116]
FA (Vol 57, Pg 5)[p121]

The term "*development expenditure*" was coined somewhere back in the late 1960's. At that time a number of items of capital expenditure on farms were classified as "*development expenditure*" and although the expenditure was capital in nature, a tax deduction was permitted – on total gross expenditure on those items, not exceeding $800 per annum.

During the 1970's the dollar limit was dropped and the list of capital items classified as "*development*" was gradually extended. "*Development expenditure*" was 100% tax deductible in those years. By the early 1980's the list of "*development expenditure*" items filled a whole page in the Income Tax Act.

Farming development expenditure has some unique features:

- It is **capital** in its nature.
- It relates to expenditure that is sunk or lost – it often becomes part of the land itself – e.g. Contouring, tracks, airstrips etc.
- Over time, it may not be able to be separately identified.
- Expenditure such as fences and power lines technically could be removed from the land but become part of improving the usefulness of the land.
- Legislation has created specific categories of farm development expenditure:
    - Some categories qualify for an immediate 100% tax deduction.
    - Others qualify for a progressive deduction (amortisation) over a number of years

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Development Expenditure Legislation

"*Sections DO 1 and DO 2 provide that all persons engaged in the business of farming or agriculture will be able to claim a full deduction of a shortened list of capital development expenditure. Deductions will be permitted for the following expenditure:*

- *the destruction of weeds, plants or animal pests detrimental to the land*
- *the clearing, destruction or removal of scrub, stumps and undergrowth*
- *the repair of flood or erosion damage to the land*
- *the planting and maintaining of trees for the purpose of providing shelter or preventing or combating erosion*
- *the construction on the land of fences for agricultural purposes, including the purchase of wire or wire netting for the purpose of making new or existing fences rabbit-proof, and*
- *the regrassing and fertilising of all types of pasture, if the expenditure is not incurred in the course of a "significant capital activity".*

A "significant capital activity" is defined in s YA 1 to mean an activity that constitutes a change in the nature or character of the farming being undertaken on the land, but does not include a change to the intensity of the farming practice. CCH

Sec DO 1
Sec DO2

Amortisation (Depreciation deduction)

A depreciation type of deduction (amortisation) is available under section DO 4 for certain expenses incurred in effecting land improvements in a farming or agricultural business.

The kinds of expenses eligible for deduction under section DO 4 are set out in Schedule 20, Part A.

Sec DO 4
Sec YA 1
Schedule 20, Part A

SCHEDULE 20, PART A, FARMING AND AGRICULTURE

	Improvement - Farming	*Percentage of diminished value of improvement allowed as deduction*
1.	unless clause 2 applies of the land for farming or agriculture, including cultivation and grassing	6
2.	regrassing and fertilising all types of pasture in the course of a significant capital activity that relates to a type of pasture with an estimated useful life of more than 1 year	6
3.	draining of swamp or low-lying lands	6
4.	construction of access roads or tracks to or on the land	6
5.	construction of dams, stopbanks, irrigation or stream diversion channels, or other improvements for the purpose of conserving or conveying water for use on the land or for preventing or combating soil erosion, other than planting or maintaining trees, whether or not on the land, for the purpose of providing shelter to the land	6
6.	construction of earthworks, ponds, settling tanks, or other similar improvements mainly for the purpose of the treatment of waste products in order to prevent or combat pollution of the environment	6
7.	sinking of bores or wells for the purpose of supplying water for use on the land	6
8.	construction of aeroplane landing strips to facilitate aerial topdressing of the land	6
9.	planting of non-listed horticultural plants on the land (see section 44C of the Tax Administration Act 1994)	12
10.	erection on the land of electric power lines or telephone lines	12
11.	construction on the land of feeding platforms, feeding yards, plunge sheep dips, or self-feeding ensilage pits	12
12.	construction on the land of supporting frames for growing crops	12
13.	construction on the land of structures for shelter purposes	12

Section DO 4(4) sets out the formula for calculating amortisation for development expenditure in farming or agricultural business from that year.

The deduction for the amortised amount each year is available irrespective of whether the taxpayer owns the land. This means that lessees can amortise any development expenditure they may incur while leasing land. ***Sec DO 4(4), (5)***

A taxpayer farming land owned by the farmer may claim a deduction for development expenditure incurred either by the farmer or any other taxpayer. This allows a deduction for expenditure incurred by a previous owner. But a taxpayer farming land that is not owned by that person/entity may only claim for expenditure incurred by them. ***FA (Vol 18, Pgs 4-6)[p126]***

It must also be expenditure that is of benefit to the farming business – that is, it must meet the deductibility rules as outlined in **MODULE ONE**. ***Sec DO 4(1), (2), (3)***

No deduction is allowable in the income year in which the taxpayer sells or otherwise disposes of the land. The new owner **can claim a deduction for the full year** regardless of the time of year that the property changes ownership – provided the expenditure is of benefit to the business in that income year

Section DO 4(6), (Schedule 20, Part A) provides that where trees or vines that **are not** planted primarily for timber production cease to exist or have ceased to be used in the derivation of gross income may have their book value written off. (However, trees or vines that ceased to be used in the derivation of gross income before 16 December 1991 cannot have their residual book value written off). ***Sec DO 4(6)***

Section DO 3(1), (2) allows a deduction for planting and maintenance expenditure incurred on tree plantings, but provides that the farming or agricultural business must be the principal business undertaken on the land before the section applies. ***Sec DO 3*** ***FA (Vol 11, Pgs 6-7)[p132]***

The deduction does not extend to expenditure for which the taxpayer receives a forestry encouragement grant, or to trees planted under a forestry encouragement agreement, or, beginning in the 1988 income year, trees planted primarily and principally for fruit-production purposes.

If a deduction is taken under section DO 2(1) for tree planting, a deduction is not available under section DO 3 for the same expenditure. In effect, section DO 3 only applies to ornamental trees and, perhaps, to woodlot operations, shade trees, farm beautification, where the farmer is not in the business of forestry.

The 100% deduction allowed under section DO 3 has been gradually phased out so that for the 1992 and subsequent income years, the maximum deduction allowed is $7,500. Farmers rarely exceed the $7,500 threshold under Section DO 3. If they are spending more than $7,500 they are probably in the business of forestry and would look to the deduction provisions under Section OP. ***Sec DO 3(2)***

Development expenditure is not always as simple as it appears. For example, how would you treat $28,000 spent on sinking three irrigation wells, all of which turn out to be dry? Where expenditure is incurred on an unproductive dry well there is no benefit to the business in the income year as is required by Section DO 4, so the expenditure should be treated as a Capital loss. That is, no tax deduction is available nor does it become a part of the cost of the land.

However, where a series of wells or bores are sunk with the outcome of a successful water source then the cost of sinking the wells (all costs including the drilling costs of dry wells/bores) would be able to be amortised.

This difference in treatment arises because dry wells with no water source outcome produced no benefit to the farming business while the eventual provision of a water source does provide a benefit to the farming business.

SELF ASSESSMENT REVIEW

- List three unique features of development expenditure. [See p17for answer].
- Give two examples of expenditure that could be removed from the land but become part of the usefulness of the land. [See p17 for answer].
- Can lessees amortise development expenditure? [See p20 for answer].
- A farmer spends $20,000 on power lines to the woolshed then sells the farm in the same year. Can the new owner amortise the expenditure? [See p20 for answer].
- A new owner of land that includes development expenditure buys the land in November. The farmer has a March balance date. How many months amortisation can the farmer claim? [See p20 for answer].