INTERPRETATION STATEMENT: IS 14/03

INCOME TAX – CONSUMABLE AIDS

All legislative references are to the Income Tax Act 2007 unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this Interpretation Statement.

This statement updates and replaces the item "Consumable aids to manufacture or production — what they are and when to claim as a deduction" published in *Public Information Bulletin* No 51 (September 1969): 11 and the item "Consumable aids – deductibility of cost" published in *Tax Information Bulletin* Vol 7, No 4 (October 1995): 13. Both items deal with the income tax treatment of consumable aids. The current relevance of this information was identified during a review of content published in Public Information Bulletins and Tax Information Bulletins before 1996. The Public Information Bulletin review has now been completed, see "Update on Public Information Bulletin review" *Tax Information Bulletin* Vol 25, No 10 (November 2013): 37.

Summary

1. Consumable aids are goods or materials that are used in the manufacture or production of goods or in the performance of services. These goods and materials are completely consumed or become unusable or worthless in a relatively short period after being applied in the process of deriving income. They do not become a component part of a finished product. Examples of consumable aids are the fertiliser used by a farmer, fuel in a car used in a business and certain short-life grinding wheels used in a mill.

2. The cost of acquiring a consumable aid is deductible when incurred in deriving income. However, if the provisions of s EA 3 apply, the expenditure incurred on consumable aids that are not used up in deriving income at the end of a person's income year is included in that person's income for the year.

3. Under Determination E12 a person is excused from complying with s EA 3 if they have an unexpired portion of expenditure on consumable aids of $58,000 or below at the end of the income year. To be excused from complying with s EA 3 under Determination E12, consumable aids must be in the possession of the person at balance date and the deduction of the expenditure must not have been deferred to a subsequent income year for financial reporting purposes.

Analysis

4. We outline below what a consumable aid is, how the expenditure on consumable aids is deductible, when expenditure on consumable aids needs to be added back under s EA 3 and how Determination E12 applies to consumable aids.

What is a consumable aid?

5. The term "consumable aid" is referred to, but not defined, in the Act. Consumable aids used in the production of trading stock are specifically excluded from the definition of "trading stock" for the trading stock valuation provisions (s EB 2(3)(g)).

6. New Zealand cases have looked at what a consumable aid is in the context of trading stock. We note that the following cases were decided when the term "consumable aid" did not appear in the relevant Income Tax Act and consumable aids were not specifically excluded from trading stock. However, we consider that these cases are still good authority on what is a consumable aid.

7. The consumable aid concept was referred to in *Case N32* (1991) 13 NZTC 3,280. The case concerned a New Zealand manufacturing plant that was part of a group of companies owned by an overseas company. The case looked at balance date adjustments for work in progress, pre-payments and consumable aids made for the 1986 and 1987 income years.

8. Barber DJ said about consumable aids, at 3,287:

> [A] distinction is drawn in tax law between consumable aids and stock in trade. **Consumable aids are articles or materials which, without becoming component parts of a finished product,** are used in the manufacture or production of goods from which a taxpayer derives its assessable income, **and are either completely or almost completely consumed or become unusable or worthless after being once applied in the process.** What is a consumable aid varies according to the business carried on. For example, as Mr Bonnar suggested, a sack of coal is stock in trade of a coal merchant, but a consumable aid of a pottery manufacturer. I agree that each case must be considered on its own facts taking into account the nature of each item used, the extent to which the item lends itself to repetitive use, and the rate of consumption to be expected from the day to day carrying on of the enterprise of the manufacture.
>
> Generally speaking, expenditure on consumable aids is a cost of business and, therefore, such expenditure may be deducted in the year of expenditure. [Emphasis added]

9. In *Case E98* (1982) 5 NZTC 59,522, the Taxation Review Authority had to determine whether the cost of bales of hay included in the purchase of a dairy farm was deductible. Part of the hay was sold on and part was used as stock feed on the farm. Bathgate DJ said the following about consumable aids, at 59,529:

> A "consumable aid" is a term recognised and used in taxation practice, although it is not referred to in the *Income Tax Act* 1976**. "Consumable aids" are goods or produce** such as cleaning agents, fuel and **other aids to, and consumed in, manufacture or production**. They are no more than aids or stores used or consumed in manufacture or production. Their nature and use distinguish these items from trading stock, as illustrated in 4 N.Z.T.B.R. *Case* 16. [Emphasis added]

10. In *Case 16* (1968) 4 NZTBR 185, the Taxation Board of Review concluded that grinding wheels with a life of 9–24 days and furnace bricks with a life of about 2½ weeks used in a steel foundry were consumable aids and not trading stock or loose tools. The board agreed with the opinions expressed and the conclusions reached about "consumable aids to manufacture" in the earlier Australian decision *Case 120* (1951) 1 CTBR (NS) 568 (discussed further below). This was on the basis that consumable aids are articles or materials that are used up in the manufacturing process, do not become a part of the goods for sale, and become unusable or worthless after one use or lend themselves to limited repetitive use. In distinguishing consumable aids from capital assets, the board summarised at 194:

> Each case will therefore involve a consideration not only of the nature of the item used but also of such factors as the extent to which it lends itself to repetitive use, the rate of consumption to be expected in the day-to-day carrying on of a company's enterprise and, as a corollary to the last-mentioned consideration, whether the volume of purchases is appropriate to the proximate needs of the manufacturer concerned.

11. In *Case 120,* the Australian Taxation Board of Review had to decide whether certain goods were consumable aids or trading stock. The board held that chemicals, cleaning fluids and various other articles used in manufacture were consumable aids because they did not become component parts of finished products and were not goods purchased for manufacture. Taxation Board of Review member F C Bock classified the different types of goods the company had recorded under "non-trading stocks" and stated at 571:

> **Goods (purchased by the company) which are rapidly consumed** in the course of being applied in the company's manufacturing processes **but do not**, to any extent, except, perhaps, adventitiously, **become integral parts of the finished products**.
>
> ...

> Their nature and functions are such that nearly all of them would be used up, or become unusable and worthless, as the result of being applied once in a manufacturing process and that **others** (only one or two), **although capable of limited repetitive use, have a very short life. Such goods are sometimes described as "consumable aids to manufacture"** and I shall refer to them by that description. [Emphasis added]

12. At 592, F C Bock concludes that cleaning agents and other aids to manufacture recorded under "non-trading stocks" do not form part of the trading stock of the company and states:

> The purpose for which they [the cleaning agents and other aids to manufacture] were acquired was not for sale or exchange either in their existing form or in a processed form suitable for sale or exchange. They comprised materials used for purposes ancillary to the business of manufacturing goods for sale and do not form a component part of such goods produced or manufactured; at no time does possession of or property in these materials pass from the company to its customers; as consumed in the process of working up raw materials into finished goods ready for sale they constitute an expense to the company which is comparable to the losses or outgoings incurred on wages of factory employees (clerks, storemen, etc.) not directly engaged in the manufacturing process.

13. From the above cases, it can be concluded that consumable aids are goods or materials to which all of the following criteria apply:

    - They are used in the manufacture or production of goods or services from which a person derives income.
    - They are completely, or almost completely, consumed at a rapid rate, or become unusable or worthless after being once applied (in the production process), or are capable of limited repetitive use.
    - They are not component parts of a finished product (or goods acquired for further processing that become part of a finished product).
    - As opposed to capital assets, they are consumed at a rapid rate or have a very short life.

    What a consumable aid is varies according to the business carried on.

14. As noted above, consumable aids have been expressly excluded from the definition of "trading stock": s EB 2(3)(g). Consumable aids are distinguishable from raw materials because consumable aids do not end up being part of the final product. Consumable aids are also generally distinguishable from spare parts because most spare parts are neither completely consumed nor become unusable or worthless in a relatively short period after being applied in the process of deriving income.

How are consumable aids different from raw materials and spare parts?

15. Consumable aids are distinguishable from raw materials. Raw materials, like consumable aids, are used in the manufacturing process. However, unlike consumable aids, raw materials are acquired to become an integral part of the finished product. Raw materials are included in the definition of "trading stock" in s EB 2(2)(b): "materials that the person has for use in producing trading stock". This means that raw materials are valued as trading stock under subpart EB. The value of a person's trading stock at the end of each income year is income of the person in the income year (ss CH 1(2) and EB 3).

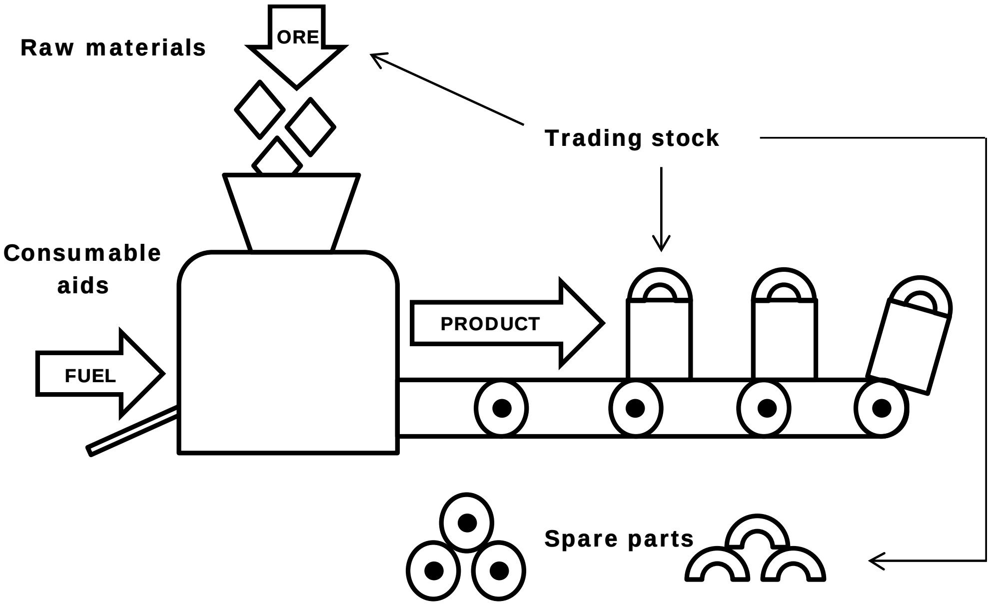
16. Spare parts are used to repair or replace components of an asset or item. Spare parts can be either trading stock or used to maintain plant that is used to derive income. Spare parts used to maintain plant are similar to consumable aids because they are used in the production process and may not actually be absorbed into any final product. Often spare parts are used when the plant or machinery breaks down or requires maintenance. This often results in the spare parts being used for a relatively long period after being applied. For this reason, most spare parts will not meet the consumable aid requirement of being completely consumed or becoming

unusable or worthless in a relatively short period after being applied in the process of deriving income.

17. Section EB 2(3)(h) specifically excludes “a spare part not held for sale or exchange” from the definition of “trading stock”. The deductibility of expenditure on spare parts is determined under general principles (general deductibility in s DA 1, and general limitations in s DA 2(1) to (6)). As opposed to consumable aids, spare parts that fall under the prepayment rules in s EA 3 do not get the benefit of Determination E12. This determination is discussed further below.

18. Most spare parts will be easily distinguishable from consumable aids because they are either trading stock or are usable for a relatively long period of time after being applied. However, there may be some goods and materials that taxpayers describe as spare parts but that also fit the description of consumable aids as outlined in this statement. These spare parts are also consumable aids and Determination E12 applies accordingly.

19. The following diagram illustrates in general terms the distinction between consumable aids, raw materials and spare parts:



Deductibility of expenditure on consumable aids

20. As previously mentioned, consumable aids to be used in the process of producing trading stock are specifically excluded from the definition of “trading stock” by s EB 2(3)(g). Therefore, they are not valued under the trading stock valuation provisions in subpart EB. There is no specific legislative regime or provision dealing with the deductibility of expenditure on consumable aids. Therefore the deductibility of expenditure on consumable aids must be determined by general principles under ss DA 1 and DA 2.

21. The cost of a consumable aid will usually be expenditure incurred in deriving income or carrying on a business for the purpose of deriving income. Consequently, the cost of a consumable aid will be deductible under the general permission in s DA 1(1) and the deduction will not usually be denied under the general limitations in ss DA 2(1) to (6).

Section EA 3 and consumable aids

22. While expenditure on buying consumable aids is deductible when incurred, this type of expenditure is also subject to s EA 3 (Prepayments). Section EA 3 sets out how to treat prepayments, where a prepayment is expenditure that the taxpayer has incurred and is allowed as a deduction but there is an unexpired portion of that expenditure at the end of the income year. Section EA 3(3)(a) provides that the unexpired amount of expenditure has to be added back as income in the same year under s CH 2. Section EA 3(3)(b) provides that this unexpired amount is deductible under s DB 50 in the following income year. Section EA 3 will be applied to this expenditure again at the end of the following income year if there is still an unexpired portion.

23. Section EA 3 explains what "unexpired" means for expenditure on goods, services and choses in action. In the context of consumable aids, the meaning of "unexpired" in relation to goods is relevant. For goods, an amount of expenditure is unexpired if the goods are not used up in deriving income and are not destroyed or rendered useless for the purposes of deriving income by the end of the income year.

Meaning of "used up"

24. There has been some uncertainty concerning at what stage a consumable aid is "used up" in terms of s EA 3(4). The words "used up" in s EA 3(4) have their ordinary meaning in this context, being "consume or expend the whole of something" (see *Concise Oxford English Dictionary*, 12th ed, Oxford University Press, New York, 2011).

25. A good has been used up in terms of s EA 3(4) when it has been expended through being consumed or incorporated into other assets in deriving income. The focus is on whether a good continues to exist and be available for deriving income beyond the income year. This is consistent with the policy intent of the provision and case law considering s 104A of the Income Tax Act 1976, the predecessor to s EA 3.

26. The concept of making adjustments for prepaid expenditure was first introduced into tax legislation in 1987 as part of the new timing or accrual rules. These rules were brought in "…to achieve a much closer matching of the timing of deductions and the timing of income recognition for tax purposes" (see the Minister's preamble in the October 1986 Consultative Document on Accrual Tax Treatment of Income and Expenditure).

27. This is consistent with the Court of Appeal decision in *Thornton Estates Ltd v CIR* (1998) 18 NZTC 13,577. This case considered whether a land developer had to add back expenditure on sections that had undergone subdivision and substantial development work but had not sold at the end of the income year.

28. Section 104A(2)(a) of the Income Tax Act 1976 had the word "used" instead of the words "used up", which are in s EA 3(4). However, the court in *Thornton Estates* found that "used" in the context of s 104A(2)(a) did not mean goods applied or employed in the income producing process. Rather, the court found that "used" only referred to goods "used up" in the income producing process.

29. The court saw the purpose of s 104A of the Income Tax Act 1976 was to "achieve a closer matching of the timing of deductions and income recognition for tax purposes". The taxpayer was allowed the deduction when the purchased goods were "expended through being consumed or incorporated into other assets" (at 13,583). The court considered the statutory description of "unexpired portion" reinforced this by referring to that which is left. The change in wording from "used" to "used up" since *Thornton Estates* seems to strengthen this.

Consumable aids used to produce other consumable aids

30. Sometimes consumable aids are used to produce other consumable aids to be used in a business. A common example of this is home-grown stock food, where a farmer uses consumable aids, such as seeds and fertiliser, to produce silage to be used on the farm. There has been some uncertainty as to how s EA 3 applies to those types of consumable aids.

31. Section EA 3(4), as it applies to consumable aids, requires the unexpired portion of a person's expenditure **on goods** to be added back, directly linking the goods and the expenditure when determining the unexpired portion that is income under s EA 3(3)(a). Section EA 3 applies in the same way in the context of consumable aids used to produce other consumable aids. That is, to determine whether an amount of expenditure on consumable aids is unexpired, the enquiry under s EA 3(3) is whether the goods have been used up in deriving income or destroyed or rendered useless for the purposes of deriving income. In the example of home-grown silage, the seeds are used up when they are planted and the fertiliser is used up with spreading. This is because they do not continue to exist as seeds and fertiliser and do not continue to be available as seeds and fertiliser. There is therefore no amount of expenditure on the planted seeds and spread fertiliser that is unexpired in terms of s EA 3. If, however, the consumable aids are used to produce trading stock (eg, stock feed to be sold), then the person has to value the produced trading stock under the trading stock valuation regime in subpart EB with the closing value of the trading stock being income under s CH 1(2).

How does Determination E12 apply to consumable aids?

32. Section EA 3(8) provides the Commissioner with the discretion to excuse certain persons from complying with s EA 3. The Commissioner has used the discretion under s 91AAC of the Tax Administration Act 1994 and issued Determination E12: Persons excused from complying with s EA 3 of the Income Tax Act 2007 (DET E12). DET E12 specifically covers consumable aids (see row (d) of the Schedule to DET E12).

33. Under DET E12, a taxpayer does not have to add back the expenditure incurred on the purchase of consumable aids as income under s EA 3 if:

    - the total of the expenditure on consumable aids that is unexpired at balance date does not exceed $58,000; and
    - the consumable aids are in the possession of the taxpayer at balance date; and
    - the deduction of the expenditure has not been deferred to a subsequent income year for financial reporting purposes.

34. Under DET E12, a person is excused from complying with s EA 3 when the unexpired portion of the expenditure on all consumable aids in total is no more than $58,000 at the end of the income year. This means expenditure of $58,000 or less on the purchase of consumable aids that are not used up does not have to be added back as income of the person. However, if the unexpired portion of expenditure on the purchase of all consumable aids exceeds $58,000 at the end of the income year, the person does not get the benefit of DET E12 and s EA 3 applies to the total amount of expenditure.

35. However, DET E12 only applies to expenditure on goods (listed in the Schedule to DET E12) to the extent that the goods are in the person's possession at balance date (see cl 4(d)) and to the extent that the deduction of the expenditure has not been deferred to a subsequent income year for financial reporting purposes (see cl 4(e)). This means that the person has to add back the expenditure for consumable aids that

are not in their possession at balance date. This is even if the total unexpired portion of expenditure for the purchase of consumable aids is below the threshold of $58,000.

36. This raises the question of the meaning of "possession" in DET E12 cl 4(d). The ordinary meaning of "possession" indicates that ordinarily "possession" is not equal to legal ownership and requires some form of power or control over the thing in possession. The inclusion of the words "in the", preceding the word "possession" in cl 4(d), also suggests that possession in this context means the goods need to be in the control of the taxpayer. This view is consistent with the common law meaning of the word "possession". The context in which the term "in the possession of" is used in DET E12, excusing the taxpayer from applying s EA 3, also supports the term "possession" having a meaning with a physical focus.

37. In the Commissioner's view, to be "in the possession of" a consumable aid in terms of cl 4(d) requires the taxpayer to have actual physical possession of the consumable aid or to have it in the taxpayer's close physical control so they can use it. Legal ownership is not relevant for determining whether a person is in the possession of a consumable aid in terms of DET E12. This means, for example, that consumable aids that have been ordered and paid for but have not been delivered by the supplier at balance date are not "in the possession of" the taxpayer within DET E12 cl 4(d).

38. A further requirement of DET E12 is that it will not apply to the extent that a person has deferred the deduction of the expenditure on consumable aids to a subsequent income year for financial reporting purposes. If a taxpayer has met the other requirements of DET E12 but has deferred the deduction for some or all of the consumable aids expenditure in their financial statements, they are not able to apply DET E12 to that deferred expenditure.

39. Note that the unexpired portion of **all** expenditure on consumable aids counts towards the $58,000 threshold in DET E12. This includes any expenditure incurred on consumable aids that are not in the person's possession at balance date and expenditure on consumable aids that has been deferred to a subsequent income year in the person's financial statements.

Examples

40. The following examples are included to assist in explaining the application of the law.

Example 1 – "Used up" requirement in s EA 3(4)

41. Egmont Ltd operates a tannery. It purchases different salts costing $120,000 to be used in the tannery. It also purchases fuel costing $10,000 to run the machinery used in the tanning process.

42. At the end of the income year, $60,000 worth of salts is still stored in the original containers. The other salts have been added, together with other chemicals, to different solutions in vats used in the tanning process. These brines and solutions are still being used at the end of the income year. $2,000 worth of fuel is still in the storage tank it was delivered to. There is also some fuel in the machinery tanks.

43. The salts still stored in the original containers are not used up in terms of s EA 3(4) as they continue to exist and are available beyond the income year. The expenditure on these salts is therefore unexpired and income of Egmont Ltd in that income year.

44. While the brine and solutions the other salts have been dissolved into still exist and are still used beyond the income year, the dissolved salts can be considered to be used up in terms of s EA 3(4). This is because the salts themselves do not continue to exist; rather they have been incorporated into the brines and solutions. There is no unexpired portion in relation to these salts.

45. The fuel still in the storage tank and the fuel that is still in the machinery tanks is not used up, as it continues to exist (as fuel) and is available to be used beyond the income year. The unexpired portion of fuel is income of Egmont Ltd. A reasonable estimate may be adopted to determine the amount of fuel still in the machinery.

46. DET E12 does not apply to excuse Egmont Ltd from complying with s EA 3 as the unexpired portion for all consumable aids is over the threshold of $58,000. Egmont Ltd needs to add back as income the total cost of the unexpired portion of salts and fuel.

Example 2 – Home-produced consumable aids

47. Daisy Hills Ltd produces grain on its farm as stock feed for its dairy cows. It plants the grains and spreads fertilizer while the crop is growing in 2013. To harvest the grain crops, the company uses a contractor. At the end of the 2013/14 income year, Daisy Hills Ltd has grain in storage that has not been fed to its cows yet.

48. The home-grown grain to be used as stock feed for its dairy cows is a consumable aid for Daisy Hills Ltd. However, there is no unexpired portion of expenditure that needs to be added back under s EA 3. This is because the grain seeds and the fertiliser have been used up in terms of s EA 3(4) by planting and spreading. The services of the contractor harvesting the grain crops have been performed. The expenditure on the seeds, fertiliser and the contractor are deductible in the 2013/14 income year.

Example 3 – Excused from complying with s EA 3 (DET E12)

49. Maclary Ltd, a hairdressing business, buys hair care products for $20,000 during the 2012/13 income year. Most of the products are used in the salon by the hairstylists. However, some of the products are sold as retail products to customers. At the end of the income year, Maclary Ltd has $6,000 worth of hair care products intended for use by the hair stylists left in the salon. There is also $800 worth of retail hair care products intended for sale to customers left in the salon. The salon does not have any other consumable aids on hand at the end of the income year and has not deferred the deduction for the expenditure on the hair care products to the subsequent income year for financial reporting purposes.

50. The hair care products for use by the stylists are consumable aids. They are used up in the performance of hairdressing services. As the threshold in DET E12 is not exceeded, the amount of $6,000 is deductible in the 2012/13 income year.

51. The retail hair care products that Maclary Ltd has for sale to customers are not consumable aids but fall under the definition of "trading stock" in s EB 2. These retail hair care products must be valued under the trading stock valuation rules in subpart EB at the end of the income year.

52. If Maclary Ltd decides in the 2013/14 income year to sell some of the hair care products ($400 worth) that were initially intended for use by the hair stylists when they were purchased during the 2012/13 income year, Maclary Ltd will need to treat those products as trading stock under subpart EB for the 2013/14 income year.

Example 4 – DET E12 threshold ($58,000)

53. Cailuna Ltd operates a paper mill. It purchases chemicals for $63,000, cleaning products for $48,000 and fuel for $52,000 during the 2012/13 income year. At the end of the income year, chemicals with a cost of $10,500, cleaning products with a cost of $40,000 and fuel with a cost of $9,000 are not used up.

54. The entire cost of the chemicals, the cleaning products and fuel is deductible in the 2012/13 income year as expenditure on consumable aids. However, because Cailuna Ltd has unused chemicals, cleaning products and fuel that in total cost $59,500, an

amount greater than $58,000, s EA 3 applies. Cailuna Ltd cannot rely on DET E12. This means the unexpired portion of expenditure of $59,500 must be returned as income in the 2012/13 income year.

Example 5 – Not in possession at balance date and DET E12

55. Piggeldy Ltd runs a pig farm. It purchases grain for its pigs costing $40,000 just before balance date. The grain was not delivered until a week after Piggeldy's balance date.

56. Even though Piggeldy had no other consumable aids on hand, and the unexpired portion of the grain was under the $58,000 threshold, DET E12 does not apply to excuse Piggeldy Ltd from complying with s EA 3. This is because, for DET E12 to apply to the expenditure on the grain, the grain needs to be in the possession of Piggeldy Ltd at balance date.

57. Piggeldy Ltd must return the $40,000 expenditure on the grain as income in the year in which the expenditure was incurred. However, Piggeldy Ltd is allowed a deduction for the $40,000 in the following year. Section EA 3 and DET E12 will apply again at the end of the following income year to determine whether any of the expenditure needs to be returned as income.

References

Related rulings/statements

"Consumable aids to manufacture or production — what they are and when to claim as a deduction", *Public Information Bulletin* No 51 (September 1969):11

"Consumable aids – deductibility of cost", *Tax Information Bulletin* Vol 7, No 4 (October 1995):13

Subject references

Income tax

Meaning of "consumable aids"

Prepayments

Legislative references

Income Tax Act 2007, ss CH 1(2), CH 2, DA 1, DA 2, DB 50, EA 3, EB 2

Tax Administration Act 1994, s 91AAC

Case references

Case 120 (1951) 1 CTBR (NS) 568

Case 16 (1968) 4 NZTBR 185

Case E98 (1982) 5 NZTC 59,522

Case N32 (1991) 13 NZTC 3,280

Thornton Estates Ltd v CIR (1998) 18 NZTC 13,577 (CA)

Appendix – Legislation

Income Tax Act 2007

1. Section CH 2 provides:

CH 2 Adjustment for prepayments

When this section applies

(1) This section applies when a person has, under section EA 3 (Prepayments), an unexpired amount of expenditure at the end of an income year.

Income

(2) The unexpired amount is income of the person in the income year.

2. Sections DA 1(1) and (2) provide:

DA 1 General permission

Nexus with income

(1) A person is allowed a deduction for an amount of expenditure or loss, including an amount of depreciation loss, to the extent to which the expenditure or loss is—

(a) incurred by them in deriving—

(i) their assessable income; or

(ii) their excluded income; or

(iii) a combination of their assessable income and excluded income; or

(b) incurred by them in the course of carrying on a business for the purpose of deriving—

(i) their assessable income; or

(ii) their excluded income; or

(iii) a combination of their assessable income and excluded income.

General permission

(2) Subsection (1) is called the **general permission**.

...

3. Sections DA 2(1) and (2) provide:

DA 2 General limitations

Capital limitation

(1) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a capital nature. This rule is called the **capital limitation.**

Private limitation

(2) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a private or domestic nature. This rule is called the **private limitation**.

...

4. Section DB 50 provides:

DB 50 Adjustment for prepayments

When this section applies

(1) This section applies when a person has, under section EA 3 (Prepayments), an unexpired amount of expenditure at the end of an income year.

Deduction

(2) The person is allowed a deduction for the unexpired amount for the following income year.

Link with subpart DA

(3) This section supplements the general permission. The general limitations still apply, but not to the extent to which any relevant general limitation was overridden by a provision that initially allowed a deduction for the expenditure, whether in this Act or an earlier Act.

5. Sections EA 3(1)–(4) and (8) provide:

EA 3 Prepayments

When this section applies

(1) This section applies when—

(a) a person has been allowed a deduction for expenditure under this Act or an earlier Act; and

(b) the expenditure was not incurred on the items described in subsection (2); and

(c) some or all of the expenditure is unexpired under subsections (4) to (7) at the end of the person's income year.

Exclusions

(2) This section does not apply to expenditure incurred on—

...

(b) trading stock valued under subpart EB (Valuation of trading stock (including dealer's livestock)):

...

Unexpired portion

(3) The unexpired portion of a person's expenditure at the end of an income year—

(a) is income of the person in the income year under section CH 2 (Adjustment for prepayments); and

(b) is an amount for which the person is allowed a deduction in the following income year under section DB 50 (Adjustment for prepayments).

Unexpired portion: expenditure on goods

(4) An amount of expenditure on goods is unexpired at the end of an income year if, by the end of the income year,—

(a) the person has not used up the goods in deriving income; and

(b) the goods are not destroyed or rendered useless for the purpose of deriving income.

...

Commissioner's discretionary relief

(8) The Commissioner may excuse a person from complying with this section under section 91AAC of the Tax Administration Act 1994.

6. Sections EB 2(1), (2), (3)(g) and (h) provide:

EB 2 Meaning of trading stock

Meaning

(1) **Trading stock** means property that a person who owns or carries on a business has for the purpose of selling or exchanging in the ordinary course of the business.

Inclusions

(2) **Trading stock** includes—

...

(b) materials that the person has for use in producing trading stock:

...

Exclusions

(3) **Trading stock** does not include—

...

(g) consumable aids to be used in the process of producing trading stock:

(h) a spare part not held for sale or exchange:

...

Determination E12

7. Clauses 2 and 4 of, and row (d) of the Schedule to, Determination E12 provide:

Determination E12: Persons excused from complying with section EA 3 of the Income Tax Act 2007

...

2 Reference

This determination is made under section 91AAC of the Tax Administration Act 1994. It determines the extent to which a person is excused from complying with section EA 3 of the Income Tax Act 2007. This determination applies for a person's income years ending on or after 1 April 2009, until this determination is cancelled by the Commissioner.

...

4 Determination

A person who, for an income year to which this determination applies, is allowed a deduction for an expenditure is excused from complying with section EA 3 of the Income Tax Act 2007 in respect of the expenditure and the income year to the extent to which-

(a) the expenditure is described by a row in column 1 of the schedule; and

(b) the unexpired portion of the expenditure and the unexpired portions of all other expenditures also described by the row do not, in total, exceed the maximum total amount specified in column 2 of the relevant row of the schedule; and

(c) the length of time between the balance date for the income year and the subsequent expiry date of the expenditure does not exceed the time period specified in column 3 of the relevant row of the schedule; and

(d) in relation to expenditure on goods specified in column 1 of rows d) and k) of the schedule, the goods are in the possession of the person at balance date; and

(e) the deduction of the expenditure has not been deferred to a subsequent income year for financial reporting purposes.

...

Schedule

Description of expenditure		Maximum total amount of unexpired portions	Time period between balance date and expiry date
Column 1		**Column 2**	**Column 3**
...			
d)	payment for purchase of consumable aids	$58,000	unlimited