Repairs and Bad Debts

MODULE 2 | 2.9.1 | STUDENT COMPANION

A repair is deductible under ITAA97 s 25-10 when it restores part of an income-producing asset to its former working condition; replacing the whole, improving it, or fixing defects it came with is capital. A bad debt is deductible under s 25-35 only when a real debt, already counted as income, has gone bad and has been written off during the year.

Specific deductions and section 8-10

Specific deductions (s 8-5) sit beside the general deduction in s 8-1. Where an outgoing fits two provisions, s 8-10 requires the most appropriate one. Routine business repairs would pass s 8-1, but s 25-10 deals with repairs directly, so it applies.

Repairs - section 25-10

The rule. Repairs to premises, or to a depreciating asset, held or used to produce assessable income are deductible in the year incurred (s 25-10(1)).

Two limits. Partly income use: deduct that proportion only (s 25-10(2)). Capital expenditure is excluded (s 25-10(3)).

Meaning of repair. Not defined in the Act. It is restoring or replacing a subsidiary part of a whole (Lurcott v Wakely and Wheeler). TR 97/23: a repair restores efficiency of function without improving the item or changing its function.

Repair or capital? Four contrasts

	Repair - deductible	Capital - not deductible as a repair
Part or whole?	Replaces a subsidiary part of the entirety	Replaces the entirety, or substantially the whole of it - even when replacing is cheaper than fixing
Restore or improve?	Brings the item back to its former condition and efficiency of function	Makes the item functionally better, or changes what it does
When did the defect arise?	Wear and damage that built up while you used the asset to earn income	Defect already there when you acquired the asset = initial repair (added to the asset's cost)
Work just before a sale	Puts right ordinary wear and tear	Makes the asset more saleable

A different material does not by itself turn a repair into an improvement.

The four contrasts

- **Part or whole.** Identify the entirety, judged by function (Lindsay v FCT). Replacing all of it is capital, even if that is cheaper than fixing it.
- **Restore or improve.** An improvement makes the item functionally better. Deduct only what was actually spent, never a notional repair cost (FCT v Western Suburbs Cinemas). A modern equivalent part can remain a repair.
- **Initial repairs.** Fixing defects present at acquisition is capital and is added to the asset's cost, even if the buyer did not know of them (Law Shipping; TR 97/23).
- **Before a sale.** Fixing ordinary wear and tear is a repair. Work to make the asset more saleable is capital.

A year of repair bills: Zdenka Novotny's pottery studio

Bill	Work done	Cost	Test	Deductible as a repair
1	Kiln heating elements burnt out; replaced with equivalent elements	$1,200	A part replaced and function restored	**$1,200**
2	Storm-damaged guttering repaired. Building is 3/4 studio, 1/4 her own flat	$1,600	A repair, but only 3/4 income use: 3/4 x $1,600	**$1,200**
3	New motor for a second-hand clay mixer, needed before it would run	$800	Initial repair = capital. Add $800 to the mixer's cost	**Nil**
4	Old pottery wheel failed. Repair quote $900; new wheel $700; she bought the new wheel	$700	Entirety replaced = capital	**Nil**

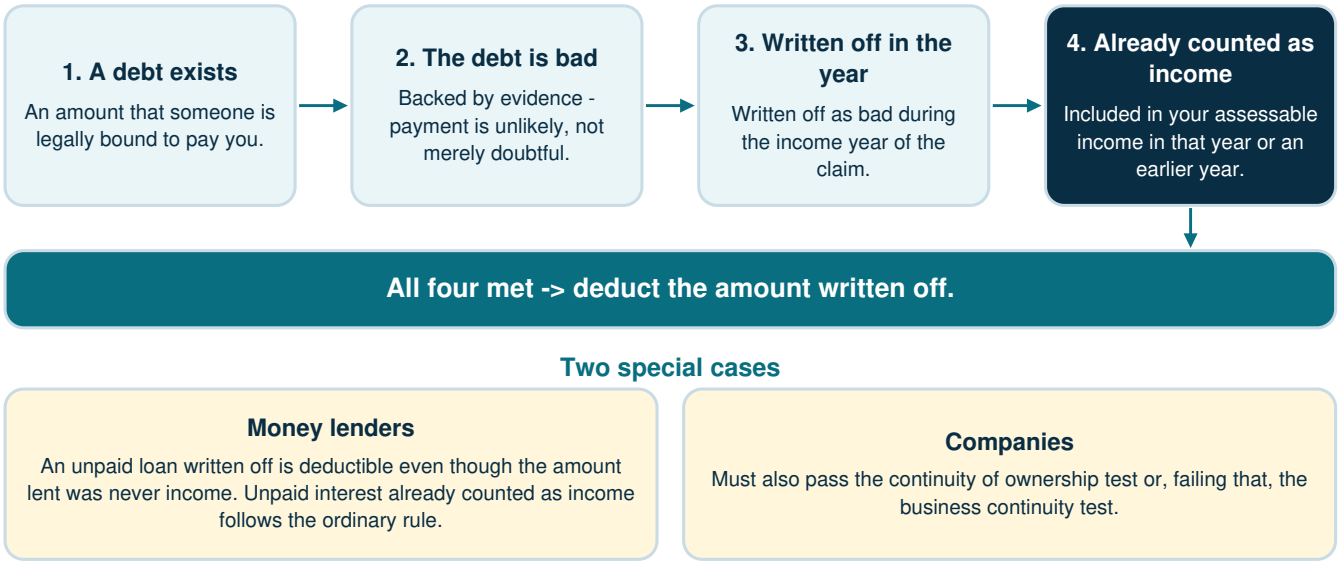
Repair deduction for the year = $1,200 + $1,200 = $2,400

Bills 3 and 4 are not wasted: they are capital and are dealt with under the capital allowance rules.

Bad debts - section 25-35

Why the deduction exists. An accruals-basis taxpayer is taxed when the customer is billed. If the debt is never paid, s 25-35 gives the tax back. A cash-basis taxpayer never counted the amount as income, so has nothing to deduct.

Bad debts: four conditions, all required



Evidence that a debt is bad (Point v FCT):

- the debtor has died leaving no assets
- the debtor, or the debtor's assets, cannot be traced
- recovery attempts have been made and abandoned
- a reasonable taxpayer would regard payment as unlikely, not merely doubtful.

Watch for. A provision for doubtful debts is never deductible. A bad debt recovered later is assessable income (s 20-20).

Key provisions

Topic	Provision
Most appropriate provision	ITAA97 s 8-10
Repairs	s 25-10(1); part use s 25-10(2); capital excluded s 25-10(3); TR 97/23
Bad debts	s 25-35(1)(a); money lenders s 25-35(1)(b)
Recovered bad debt	s 20-20
Company test: continuity of ownership	More than 50% of voting, dividend and capital rights

Practice questions

MODULE 2 | 2.9.1 | TRY THESE BEFORE THE WORKED ANSWERS

Question 1 - Repair or capital?

Imelda Castellanos operates a commercial laundry as a sole trader. She owns the two-storey building. The laundry occupies the ground floor, which is 60% of the floor area, and she lives in the flat upstairs, which is the other 40%. All of the laundry equipment is used only in the business. During 2024-25 she paid for the six jobs below. For each job, decide how much is deductible under ITAA97 s 25-10 and explain why. Then total her repairs deduction for the year.

Job	Work done	Cost
1	Replaced the worn drum bearings and door seal on an industrial washing machine with equivalent parts	$1,800
2	She bought a second-hand steam press for $6,000. Its boiler valve was corroded when she bought it and had to be replaced before the press could be used	$900 for the valve
3	A tumble dryer's motor burnt out. The repair was quoted at $2,600. A new dryer of the same capacity cost $2,200, so she scrapped the old dryer and bought the new one	$2,200
4	Replaced a burst section of the main water pipe that serves both floors of the building	$1,500
5	Removed the timber loading ramp at the back door, which was in sound condition, and built a wider concrete ramp so that linen trolleys could be wheeled straight into the van	$4,000
6	Just before selling her old folding machine, which she used in the laundry until the day it was sold: (a) replaced its feed belt, frayed through ordinary use, $300; (b) had it resprayed and fitted with a digital counter it never had, to attract a better price, $650	$950

Question 2 - Bad debts at 30 June

Seraphine Fairbrother runs Fairbrother Scaffolding as a sole trader and returns income on an accruals basis. She is not a money lender. At 30 June 2025 her records show the following.

Item	Amount	Facts
A	$4,400	Invoiced to a building company in October 2023 and included in her 2023-24 assessable income. The company went into liquidation. In April 2025 the liquidator's final report confirmed that unsecured creditors would receive nothing. Seraphine wrote the debt off in her ledger on 15 May 2025.
B	$2,500	Invoiced to a shopfitter in February 2025. The account is four months overdue. The shopfitter is still trading, has apologised and has promised to pay soon. Seraphine has her doubts and has counted the amount in her provision for doubtful debts.
C	$3,000	Invoiced to a home renovator in March 2025. He died in May 2025, and on 12 June 2025 his executor confirmed in writing that the estate has no assets. Seraphine made the write-off entry on 14 July 2025, when her accounts were being finalised.
D	$1,600	An interest-free personal loan paid from the business bank account to a former employee. He has moved overseas and cannot be traced. Seraphine wrote the loan off on 30 June 2025.
E	$5,000	The increase for the year in her general provision for doubtful debts.

(a) For each item, test the four conditions and state the amount deductible as a bad debt for 2024-25.

(b) What is her total bad debt deduction for 2024-25?

(c) When, if at all, can item C be deducted?

(d) In August 2025 the liquidator in item A unexpectedly pays Seraphine $700. How is that amount treated?

Question 3 - Three special cases

Explain what each taxpayer can deduct for 2024-25.

(a) Dr Benedikt Winterbourne is a vet in sole practice who returns income on a cash basis. At 30 June 2025 clients owe him $3,800 for treatment that he is certain will never be paid for, and he writes the amounts off.

(b) Tamarind Finance Pty Ltd lends money to small businesses in the ordinary course of its business and returns interest income on an accruals basis. A borrower has disappeared owing $18,000 of loan principal and $2,000 of interest, which Tamarind has already included in assessable income. On 20 June 2025 Tamarind writes off the full $20,000 as bad. Assume Tamarind passes the company tests mentioned in (c).

(c) Delahunty Freight Pty Ltd returns income on an accruals basis. On 10 June 2025 it writes off a genuine bad trade debt of $9,000 that was included in its assessable income in 2023-24. In January 2025, after the debt arose and before it was written off, 70% of the company's shares were sold to an unrelated buyer. The company carries on exactly the same freight business as before. What extra requirement applies because the taxpayer is a company, and is it likely to be met?

Worked answers

MODULE 2 | 2.9.1 | WORKED ANSWERS - ATTEMPT THE QUESTIONS FIRST

Answer 1

Work through the four contrasts for each job: part or whole, restore or improve, when the defect arose, and work before a sale. Then check how far the asset is used to produce income.

Job	Deductible under s 25-10	Reason
1	$1,800	The washing machine is the entirety. Bearings and a door seal are subsidiary parts, replaced with equivalents, which restores the machine without improving it. The machine is used wholly in the business, so the full cost is deductible.
2	Nil	The valve was already defective when she bought the press. Fixing it is an initial repair, which is capital: it is really part of the cost of acquiring a working press (Law Shipping). The $900 is added to the cost, giving $6,000 + $900 = $6,900 for capital allowance purposes.
3	Nil	She replaced the entirety, the whole dryer. That is capital, even though replacing was cheaper than repairing. She cannot claim the $2,600 quote, or any part of it, as a notional repair: only what was actually spent counts, and it was spent on a new asset (Western Suburbs Cinemas). The $2,200 is dealt with under the capital allowance rules.
4	$900	Replacing a burst section of pipe restores part of the building, so it is a repair to premises. The building is only partly used to produce income, so only that proportion is deductible (s 25-10(2)). On a floor-area basis: 60% x $1,500 = $900. The other $600 relates to her home.
5	Nil	Nothing was broken or worn, so nothing was repaired. A wider concrete ramp in place of a sound timber one is an improvement, which is capital (s 25-10(3)).
6	$300	(a) $300: replacing the frayed belt puts right ordinary wear and tear from using the machine to earn income. It is a repair even though it was done just before sale. (b) $650: respraying and adding a counter the machine never had were done to make it more saleable and go beyond restoring it. That is capital.

Total repairs deduction for 2024-25: $1,800 + $900 + $300 = $3,000.

Answer 2

(a) The four conditions: 1. a debt exists; 2. the debt is bad; 3. it was written off as bad during the income year; 4. the amount was included in assessable income in that year or an earlier year.

Item	Deductible in 2024-25	Reason
A	$4,400	1. The company still owes the debt. 2. It is bad: the liquidator's final report shows nothing will be paid, so a reasonable taxpayer would regard payment as unlikely. 3. Written off on 15 May 2025, within 2024-25. 4. Included in assessable income in 2023-24. All four conditions are met.
B	Nil	Fails conditions 2 and 3. The debtor is still trading and has promised to pay, so the debt is doubtful, not bad, and it has not been written off. Counting it in a provision is not a write-off.

Item	Deductible in 2024-25	Reason
C	Nil	Conditions 1, 2 and 4 are met: the debtor died leaving no assets, and the March 2025 invoice is in 2024-25 assessable income. Condition 3 fails: the write-off entry was made on 14 July 2025, after the year ended.
D	Nil	Fails condition 4. The loan was never included in her assessable income, and she is not a money lender. Writing it off does not help.
E	Nil	A provision is an estimate. No particular debt has been written off as bad.

(b) Total bad debt deduction for 2024-25: **$4,400**.

(c) Item C is deductible in 2025-26, the income year in which it was written off (14 July 2025), provided the debt still exists and is still bad at that time. The deduction arises only in the year of the write-off.

(d) The $700 is assessable income in 2025-26, the year it is received, under s 20-20, because it recoups an amount she deducted earlier. Her 2024-25 deduction of $4,400 is not reopened.

Answer 3

(a) Nothing. On a cash basis, fees are assessable only when received, so the unpaid $3,800 has never been included in his assessable income. The fourth condition fails. He has paid no tax on the amount, so there is nothing for a deduction to correct.

(b) $20,000 in total.

- Principal, $18,000: deductible under s 25-35(1)(b). Tamarind lent the money in the ordinary course of its business of lending money, so the loan written off is deductible even though the amount lent was never assessable income.
- Interest, $2,000: deductible under s 25-35(1)(a), the ordinary rule, because the interest was included in assessable income and has now been written off as bad.
- $18,000 + $2,000 = $20,000.

(c) As well as the four conditions in s 25-35, a company must satisfy the same additional tests that apply when a company deducts tax losses of earlier years: the continuity of ownership test or, if it fails that, the business continuity test.

- Continuity of ownership: the same persons must hold shares carrying more than 50% of the voting, dividend and capital distribution rights throughout the test period. 70% of the shares changed hands in January 2025, so the test is failed.
- Business continuity: the company can still deduct if it carries on the same business (or, under the alternative limb, a similar business). It carries on exactly the same freight business, so this test should be passed.

On these facts the $9,000 should be deductible. The detail of both tests is covered with tax losses.