Tax in Focus

TAX

09TiF-004 Investment allowance for business – Bill introduced 20 March 2009

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Introduction

Tax Laws Amendment (Small Business and General Business Tax Break) Bill 2009 (the Bill) was introduced into Parliament on 19 March 2009. It provides for a temporary tax break for Australian businesses with a view to encouraging business investment and economic activity. This proposal was announced in the Treasurer's media releases of 3 February 2009 (No.012) and 12 December 2008 (No.141).

The Bill proposes to insert a new Division 41 into the *Income Tax Assessment Act 1997* (ITAA 1997) to provide a 30 or 10 percent investment allowance (IA) tax deduction for certain new investment in tangible depreciating assets.

The Bill's introduction follows the release of exposure draft (ED) legislation on 25 February 2009 and the receipt by Treasury of numerous industry submissions on the ED.

KPMG has previously released Brief 09TiF-003 *Investment allowance for business – draft legislation released* and Brief 08TiF-038 *Investment allowance and PAYG announcements* in connection with the IA proposal. KPMG also lodged a submission (and supplementary addendum) with Treasury on the ED in the week ending 13 March 2009.

AUDIT ▪ TAX ▪ ADVISORY

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Key changes from the ED

A comparison of the previous ED with the current Bill highlights the following key points:

- Changes have been made in the Bill to correct drafting errors in the ED for IA claims to be made by taxpayers with substituted accounting periods (SAP).
- Modifications have occurred to expand the type of investment that may qualify. Expenditure on other assets that form part of a batch or set of assets can now be aggregated in working out whether the 'new investment threshold' of $1,000 or $10,000 has been met. A similar aggregation rule has been introduced for jointly held assets.
- Refinements have been made to the rules requiring the asset to be used in Australia in carrying on a business.

Importantly, a number of submission points made by various industry bodies have not been incorporated in the Bill, namely:

- The key start dates and sunset dates have not been modified.
- The type of investment that may qualify for IA has not been extended to cover:
  - application software
  - imported second hand assets
  - certain water facility assets.
- Lessors will not be able to transfer an entitlement to the IA deduction to the lessee (other than by being factored into the lease price).

Analysis of the Bill

Eligibility criteria – new investments

Prima facie, all taxpayers can qualify for the IA if they satisfy the criteria in the following table:

New investment threshold	**Investment commitment time 13/12/08 to 30/06/09 First use time by 30/06/10**	**Investment commitment time 13/12/08 to 31/12/09 First use time by 31/12/10**
Small business - $1,000	30%	10%
Other business - $10,000	30%	10%

The basic criteria to qualify for an IA deduction is that:

- you hold a tangible depreciating asset for which you are entitled to claim a capital allowance deduction under Subdivision 40-B of the ITAA 1997 (or specified inclusions apply)
- you have one or more 'recognised new investment amount(s)' which means:
  - you have incurred capital expenditure on a new tangible depreciable asset (or new capital expenditure on an existing asset) pursuant to certain acquisition arrangements entered into within the abovementioned 'investment commitment time' (see table)
  - the asset is installed ready for use within the abovementioned 'first use time' (see table)

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- it is reasonable to conclude that you will use the asset principally in Australia for the principal purpose of carrying on a business; and

- the total of your 'recognised new investment amounts' for the asset for the income year equals or exceeds the abovementioned 'new investment threshold' (see table) for the income year in relation to the asset.

The prior uncertainty in the ED over the operation of the 'investment commitment time' and 'first use time' for entities with SAPs has been rectified in the Bill. Thus, the start and sunset dates in the above table constitute fixed dates for all taxpayers, irrespective of their tax year ends.

Pre-13 December 2008 acquisition arrangements and sunset dates

A number of industry submissions on the ED had recommended the IA should be extended to cover assets acquired under pre-13 December 2008 contracts and that the last date by which an asset must be installed ready for use should be extended from 31 December 2010 to 31 December 2011.

Such recommendations have not been incorporated into the Bill.

The Bill has, however, sought to clarify that you do not enter into a contract under which you hold an asset merely because you acquire an option to enter into such a contract. The Explanatory Memorandum (EM) at 1.108 notes that if, prior to 13 December 2008, a taxpayer enters into a contract which includes the option to acquire the eligible asset at a later point in time, then an IA deduction may still be available provided the option is exercised on or before 31 December 2009. Apart from this point of clarification there is no further substantive guidance on when you 'enter into a contract' in the EM.

Self-constructed assets

Industry submissions on the ED had sought further clarity on the 'start to construct' criteria for the 'investment commitment time'. The EM at 1.104 notes that the start time for construction of an eligible asset occurs when the taxpayer has demonstrated a clear intention or commitment to proceed. Interestingly, Example 1.16 of the EM then suggests that a clear intention or commitment to proceed will have occurred when the relevant decision makers (e.g. directors) have signed off a decision to proceed with construction (as opposed to when the actual physical aspects of construction commences).

Use in Australia test

The use in Australia test has been clarified in the Bill. To qualify for an IA deduction, a taxpayer must now be able to demonstrate that at the 'first use time', it is reasonable to conclude that you will use the asset principally in Australia for the principal purpose of carrying on a business. The Bill also provides that an asset will therefore fail the test if at the 'first use time', it is reasonable to conclude that the asset will never be located in Australia. On the other hand, an asset will not necessarily have to be located in Australia at the 'first use time' provided your principal use will ultimately be in Australia.

With regard to assets held under leases, the EM at 1.67-1.68 notes that the lessor must be able to demonstrate at 'first use time' that it's reasonable to conclude they (i.e. the lessor) will use the asset principally in Australia. The suggestion is then made that a lessor need not look through to the actual use of the asset by a lessee. However, the EM then notes that a lessor will not be able to claim an IA deduction on an asset where it is reasonable to conclude it will never be located in Australia (which does suggest actual end use may still be relevant in some cases).

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Eligible assets

As noted earlier, the IA is only available in respect of expenditure on a new tangible depreciating asset (or new expenditure on an existing asset) that exceeds the 'new investment threshold'.

Following industry submissions on the ED, the Bill has modified the operation of the IA provisions when dealing with batches and sets of assets as well as jointly held assets.

Batches and sets of assets

The general rule is that a taxpayer must satisfy the 'new investment threshold' for each individual asset. Accordingly, whilst multiple investments in the same, individual asset may be aggregated, investment aggregation across unrelated assets is not allowed.

Notwithstanding the above, the Bill does provide for aggregation where two or more assets are either part of a set of assets, or they are substantially identical. Thus a 'recognised new investment amount' for the income year in relation to a relevant asset can include a 'recognised new investment amount' in relation to another asset where they are part of the same set of assets or are substantially identical, for the purposes of testing the 'new investment threshold'.

By way of clarification, the EM at 1.80-1.83 notes that:

- Taxpayers will still need to consider each asset individually. The assets forming the 'set' must still fit the relevant criteria to claim the IA deduction (e.g. they must be new tangible depreciating assets that satisfy the 'investment commitment time' and 'first use time' requirements).

- Whether assets form a set must be determined on a case-by-case basis. They may be regarded as a set of assets if they are dependent on each other, marketed as a set, or designed and intended to be used together.

- In some cases, more than one item will still only make up a single, depreciating asset. The example given is a computer consisting of a hard drive, monitor and mouse which is considered to be a single asset, rather than a set of assets.

The EM also provides the following examples:

- A landscaping business buys a lawn mower, brush cutter and leaf blower – each of these are considered single depreciating assets, not a set and accordingly cannot be aggregated [Example 1.11].

- A courier service installs a base station for a two-way radio system used to communicate with drivers. The drivers also have handsets installed in their delivery vans – the base station and handsets are considered a set as they are intended to function together [Example 1.12].

- A supermarket replaces all its shelving in seven of its stores across Australia – this amounts to 10,000 units of shelving each with a cost of $120. It is considered the shelving units are substantially identical – hence they can be aggregated [Example 1.26].

Jointly held assets

For jointly held assets an interest in the underlying asset is treated as a separate depreciating asset. In these circumstances, the Bill provides that aggregation can occur in respect of expenditure incurred by another person on the same underlying asset, for the purposes of testing the 'new investment threshold'.

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This should assist, for example, joint venture participants in mining and petroleum operations in taking full advantage of the IA concession. Joint holders may need to exchange information on their capital expenditure to satisfy these requirements.

New assets

The Bill has retained the concept of 'reasonable testing and trialling' contained in the ED. In effect, this provides that an asset will still be considered new if it has merely been used for the purposes of reasonable testing and trialling.

However, Example 1.5 in the EM now notes that prior use of a 'demonstrator' car (driven to and from work by a car dealer prior to selling it) will not fall under the umbrella of 'reasonable testing and trialling' of the car, thus rendering the third party purchaser ineligible to claim an IA deduction. This example does beg the question of what enquiries must a third party purchaser make when acquiring a demonstrator motor vehicle. On a more helpful note, the EM at 1.59 does confirm that an asset will not be precluded from IA because it was purchased from someone who held it as trading stock or ready for sale.

What's in

Consistent with the ED, the Bill provides that an IA deduction may be available for:

- An asset used for research and development (R&D).
- Motor vehicles where the taxpayer is using the '12 percent of the original value', 'one third of actual expenses' or 'log book' method to determine the deductible car expenses for an income year.
- A small business entity that chooses to deduct amounts for depreciating assets under the capital allowances provisions in the ITAA 1997 for small business entities.

Whilst these assets may, prima facie, be eligible to qualify for an IA deduction, all the requirements (e.g. 'investment commitment time', 'first use time' and use principally in Australia for the principal purpose of carrying on a business) will still need to be satisfied.

What's out

Consistent with the ED, land, trading stock, capital works on buildings and motor vehicles where the 'cents per kilometre' method is used are not eligible for the IA.

A number of industry submissions on the ED had recommended that the IA should be broadened to include:

- intangibles, such as application software expenditure
- imported second hand assets
- certain water facility depreciating assets.

Such recommendations have not been incorporated into the Bill.

Who can claim the IA?

As noted above, the 'holder' that is entitled to the capital allowance deductions is the taxpayer that is able to claim the IA deduction.

For example, in a leasing arrangement, the IA is available to the entity in the leasing arrangement who would claim capital allowance deductions in relation to the asset under the capital allowance provisions. In relation to a luxury car lease, the holder is the lessee and not the

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lessor (and the IA deduction is subject to the luxury car cost limit). In most other genuine leasing arrangements the lessor would be the holder of the asset.

Inability of lessor to transfer tax benefit

Under the Bill (and notwithstanding industry submission points on these issues):

- Lessors who are the 'holder' of the asset for capital allowance purposes will not be able to transfer their entitlement to the IA deduction to the lessee by way of a notification process. In these circumstances, any transfer of the IA benefit would need to be factored into the lease price by commercial negotiation.
- Large lessors will not be able to access the $1,000 'new investment threshold' when leasing assets to small business taxpayers.

This has significant ramifications for equipment financing decisions given that different types of financing arrangements will result in the IA deduction being claimed by different taxpayers.

Calculating the IA deduction

Broadly, the IA deduction is a function of the asset's cost as determined under the capital allowance provisions and the IA rate (either 30 percent or 10 percent, the rate depending on the 'investment commitment time' and the 'first use time').

The cost of an asset for capital allowance purposes would generally be exclusive of goods and services tax (GST). The IA deduction will also be generally calculated on a GST exclusive basis.

Examples 1.14 and 1.27 in the EM contain an explanation on how the IA is calculated:

Frank and Gail (small business taxpayers) purchase identical new ovens for the principal purpose of use in carrying on café businesses in Australia. The relevant facts in relation to Frank's investment in his oven are as follows:

- Investment commitment time = 29 June 2009
- First use time = 17 August 2009
- Recognised new investment amount = $5,000 (included in the asset's first element of cost)

For the 2009-10 income year, Frank can therefore claim the IA at the 30 percent rate. His IA deduction is $1,500 for the 2009-10 income year.

The relevant facts in relation to Gail's investment in her oven are as follows:

- Investment commitment time = 10 August 2009
- First use time = 17 August 2009
- Recognised new investment amounts = $5,000 ($4,500 (first element of cost) + $500 (for installation costs, which is included in the second element of cost))

Gail's IA deduction will be $500 for the 2009-10 income year. Gail will not be eligible for the 30 percent rate because the 'investment commitment time' is after 30 June 2009.

The IA deduction will not impact on the taxpayer's existing capital allowance deductions in relation to the asset. This means that over the life of the asset the sum of the existing capital allowance deductions and the IA deductions can be more than 100 percent of the asset's cost. The EM at 1.116 also notes that the IA will not be clawed back for any subsequent non-business

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use of the asset or if the asset is subsequently disposed of provided that the purpose test was genuinely satisfied at the 'first use time'.

Legislative process

The introduction of the Bill on 19 March 2009 coincides with the last Parliamentary sitting date for the Autumn sitting.

The Selection of Bills Committee, in Report No. 4 of 2009, tabled in the Senate on 19 March 2009 recommended that the Bill not be referred to a Committee for inquiry and report.

The earliest opportunity for Parliamentary debate on the Bill to resume will be when Parliament returns for the Winter sittings on Tuesday 12 May 2009 and the handing down of the Federal Budget.

Given the current Parliamentary sitting schedule, the best case scenario for the Bill to be passed by both Houses of Parliament is by May/June 2009.

KPMG Observations

The Bill provides businesses with an opportunity (for a limited time only) to obtain a $9 benefit for every $100 spent on eligible assets.

Businesses should be mindful of the legislative processes required to convert the Bill into law and the critical dates when executing contracts for new capital expenditure. Only new capital expenditure under a contract entered into (or constructed) and installed ready for use during the specified start and sunset dates will qualify for either the 30 percent or 10 percent IA. Equipment financing strategies could impact on the availability and incidence of an IA deduction.

Businesses should review their existing fixed asset registers to identify assets acquired since 13 December 2008 that may be eligible for the IA.

Organisations selling assets that could qualify for the IA may need to incorporate information on the IA into their sales programs.

In addition, the impact of IA on salary packing arrangements (e.g. motor vehicles) may need to be considered and communicated to employees.

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