

Tax Brief

24 March 2009

Investment Allowance – Bill Enters Parliament

The Government introduced into Parliament on Thursday 19 March a Bill to enact the investment allowance.

The Bill differs slightly from the Exposure Draft Bill released on 25 February 2009 in a few respects – there are new provisions about the location of assets, to deal with taxpayers with substituted accounting periods, to make it clearer that some amounts can be aggregated in determining whether expenditure has reached a required threshold and to clarify the interaction with the R&D regime, for example.

But with these exceptions, and a few cosmetic changes to the definitions of terms, the Bill continues the previous design.

Key points

The Bill gives effect to the key points of the Government's announcement:

- the allowance is delivered in the form of a new additional allowable deduction in the year in which an asset is installed ready for use or money on improving an existing asset is spent;
- the table below summarises the key dates relating to the different rates at which the allowance can be claimed as regards the cost of the item or improvements for taxpayers with a 30 June year end:

	New Investment after 12 December 2008 and by:	
Installed by:	30 June 2009	31 December 2009
30 June 2009	30% in 2008-09	
30 June 2010	30% in 2009-10	10% in 2009-10
31 December 2010	10% in 2010-11	10% in 2010-11

- in the above table, "investment" means acquiring an asset, entry into a contract to acquire an item or commencement of construction;
- no deduction is available if the item or improvement is either:

- acquired, a contract is entered or construction commences after 31 December 2009; or
- installed after 31 December 2010.
- for expenditure on buying or constructing new assets, the allowance is deducted in the first year that the item is used or installed ready for use. For expenditure on improvements to existing assets, the allowance will generally be deducted in the year that the expenditure is incurred;
- the deduction does not affect the taxpayer's depreciation or the computation of a balancing charge if the asset is sold or scrapped;
- the allowance is only available for expenditure on tangible depreciating assets (including cars) which qualify for depreciation deductions under Division 40 of the *Income Tax Assessment Act 1997* ("ITAA 1997");
- the allowance is given to the taxpayer entitled to claim depreciation, including equipment lessors;
- the incentive is available for both the cost of acquiring and constructing additional assets and for the cost of making non-deductible improvements to existing assets;
- for large businesses – in general terms, businesses with an annual turnover over \$2m – the amount spent on acquiring or improving the asset must be \$10,000 or more to qualify for any incentive, although this figure can include amounts spent in some prior years, by some other taxpayers, on assets that form part of a set or a collection of identical assets; and
- the relevant asset must have been acquired under a contract entered into, or the construction or improvements must commence, on or after 13 December 2008, and for this purpose, an option to acquire the asset will not suffice.

The allowance is available only to taxpayers carrying on a business; investors do not qualify.

Some elaborations

Leasing. The former investment allowances (the Investment Allowance which operated from 1975 to 1985 and the Development Allowance which operated from 1992 to 2002) both contained highly elaborate rules restricting the availability of the incentive where the asset was leased.

Judging by the two announcements, the rules governing the allowance were intended to be far less constrained and this impression is confirmed by the Bill. The allowance is afforded to the taxpayer who enjoys the depreciation deduction, which, for equipment, would ordinarily mean the lessee of a luxury car, the lessor of items provided under an operating or finance lease, or the hirer under a hire purchase arrangement or the buyer under an instalment purchase arrangement.

Some of the issues that will arise if an eligible asset is leased to a non-resident, or used by a lessee outside Australia, or both, are discussed below.

Start date. The allowance is available if the taxpayer has entered a contract to acquire the asset, or construction of the asset commences, after 12 December 2008. This same rule applies whether the incentive is being claimed for the costs of buying, constructing or improving an asset. If the taxpayer has entered a contract with another person to construct an asset for it, the explanatory material accompanying the Bill says the date of contract rule is applied and not the commencement of construction rule.

A special anti-avoidance rule has been added to try to prevent taxpayers cancelling and re-entering contracts executed prior to 13 December 2008, or ceasing and then re-commencing construction or improvements to an asset after 12 December.

Because the regime specifically contemplates making improvements to existing assets, taxpayers who contract for new expenditure after the start date can qualify, even if that expenditure is for items that will be absorbed into assets acquired before the start date. This largely eliminates kinds of disputes that arose under previous investment allowances about whether the taxpayer's expenditure was acquiring a discrete new additional asset (which would qualify) or improving an existing asset (which would not).

New and used assets. The previous investment allowances dealt only with the cost of acquiring or constructing assets – not making improvements to existing assets – and so it was common practice to restrict access to those incentives just to “new” – in the sense of unused – assets. It is probably no great surprise, therefore, that the current incentive is also effectively restricted to the cost of acquiring or constructing new assets. The restriction is effected through a requirement that “the first time that you or any other entity have used the asset for any purpose” (other than testing or trialling) occurs during the relevant periods.

Note, however, that this limit only applies if the taxpayer wants to claim the incentive for the cost of acquiring or constructing additional assets. If the taxpayer wants to claim the incentive for the cost of making improvements to existing assets, this restriction is not relevant.

Which depreciating assets. The incentive is made to work by tying it to the operation of the depreciation rules in Division 40 ITAA 1997, and more specifically, just to the core rules in Division 40, not the entire regime. Tying the allowance just to these rules has implications that are obvious and some that are not.

This tie is the rule which restricts access to the incentive to the cost of acquiring or improving assets that qualify for depreciation rather than, say, trading stock, most buildings and capital works, or non-depreciating capital assets such as land or shares.

This mechanism also links the threshold – the asset or improvement must cost more than \$10,000 if the taxpayer is a large business – to the item which is the depreciating asset under Division 40. But rules in the Bill allow

a taxpayer to aggregate expenditures incurred in prior years, expenditures on separate but related assets and expenditure incurred by a joint owner for the purpose of determining whether the relevant threshold has been met.

However, the tie to the depreciation rules is both under-inclusive and over-inclusive in terms of the assets covered and so some adjustments are then made. For example, all intangible depreciating assets are excluded. Hence, the cost of acquiring or developing new software, patents or other intangibles is ineligible.

But tying the incentive just to the core depreciation rules would exclude some cars, assets that qualify under the R&D regime and some small businesses from the allowance because the depreciation claim for these assets is made under rules other than the core rules in Division 40 ITAA 1997. Small business assets, R&D assets and some cars are thus specifically added back so that expenditure on these assets may be eligible. However, other special regimes – for example, who claim a deduction for car expenses based on the cents per kilometre method or use various rules for primary producers, mining or environmental protection – are not added back and expenditure which gives rise to depreciation deductions under those rules remains ineligible.

Place of use and location of leased assets. The provisions require that “you will use the asset principally in Australia ...” This type of verbal formula is common and it has always presented difficulties for leased assets – whose use is to be examined? Is the test satisfied if the lessor carries on business in Australia or is it necessary to consider where the lessee will use the asset? And if so, is this in addition to, or in substitution for, examining the lessor’s use?

The Bill and the explanatory material seem relatively clear that it is the lessor’s use which is relevant: will the lessor be supplying the asset through a business it carries on in Australia?

However, that is not the end of the story. The Bill adds a new requirement which was not in the exposure draft: the allowance will not be available if it is reasonable to expect that “the asset will never be located in Australia.” This suggests that an additional test must be satisfied – the lessee must be going to locate the asset in Australia. The word “locate” suggests something more than a fleeting presence in Australia, but just how much more permanence is required is obviously going to prove difficult. In short, the lessor will not be entitled to the allowance unless it is reasonable to expect at the time the asset is first put to use that the asset will, at some time, be located by the lessee in Australia.

Tax-preferred use of assets. Furthermore, the explanatory material is silent about how the use and location rules for the allowance are meant to fit with the rules about the tax-preferred use of assets in Division 250 ITAA 1997. These rules come into play if an asset is acquired by a taxpayer carrying on business in Australia but leased to a taxpayer who uses it in whole or in part outside Australia. If that situation triggers the special rules on the tax-preferred use of assets, it seems that the allowance will not be available to the lessor – the rules in Division 250 will strip the lessor of the

depreciation deduction and as a consequence, the lessor would not be entitled to the allowance as well.

Mixed use and changed use of assets. The Bill contains no explicit rules about pro-rating the allowance if the asset is used to produce exempt income. Nor are there explicit rules about the impact of a post-acquisition change of use. The explanatory material is quite explicit that the test is whether the asset was genuinely intended to be used in carrying on a business in Australia, determined once and at the time that the asset was *first* used or installed ready for use.

As was noted above, the provisions require that the asset be used in carrying on a business in Australia, and this removes the possibility that the asset might be purchased in Australia for use in a branch which generates exempt income. Hence, a taxpayer who acquires an asset for use in a foreign branch will not become entitled to the allowance if the asset is relocated into Australia, and a taxpayer who genuinely acquires an asset for use in Australia will not have to refund some or all of the allowance if the taxpayer subsequently decides to relocate the asset offshore.

Distributions of tax-sheltered income. The Bill makes no amendments to the rules about distributions from trusts and companies which represent untaxed amounts such as the allowance. Hence, the incentive will prove most valuable for companies which retain profits. For companies which in effect distribute the allowance, the distribution will be unfranked to that extent and the value of the allowance will be clawed back from the shareholder; for beneficiaries and unitholders of fixed trusts, the allowance will be clawed back by reducing the investor's cost in its interest.

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These notes are in summary form designed to alert clients to tax developments of general interest. They are not comprehensive, they are not offered as advice and should not be used to formulate business or other fiscal decisions.

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