

Tax Brief

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The Rise and Fall (and Rise and Fall) of the Investment Allowance

When recession threatens, private business investment usually falls and governments typically respond with a combination of public investment and increased tax benefits for private investment. History repeated itself on 12 December 2008 when the Rudd Government announced a 10% investment allowance in the form of a deduction for business investment expenditure on new equipment for use in Australia committed up to 30 June 2009 and in place by 30 June 2010.

Similar incentives existed during hard times from the late 1970s to the early 1980s and again in the early 1990s. The new investment allowance is part of a larger package which includes large government spending on infrastructure.

Although we are in the midst of the global financial crisis, the new allowance is in some ways more modest than its predecessors and more generous in other respects. It shares many common features with its antecedents. The announcement is silent on some issues on which there were detailed rules in the past and it is not clear to what extent these rules, mainly of an integrity nature, will be repeated this time around.

It is important to note that, as the allowance operates as an additional deduction of 10% of the cost of an asset, its value depends on the taxpayer's tax rate. For large business, this will generally be the corporate rate of 30%. In the past when investment allowances were in operation, corporate tax rates were considerably higher and so the allowance was more valuable for each dollar of deduction available. Further as with the most recent incarnation – the 10% Development Allowance of the early 1990s – the imputation system means that income sheltered by the investment allowance will eventually emerge as unfranked dividends in the hands of shareholders. For trusts, the value of the allowance will depend on the tax rate of the investor in the trust.

What kinds of assets are covered?

There are five main conditions relating to the types of assets that qualify for the new investment allowance:

- The asset must be tangible and qualify for capital allowances under the basic provisions in Division 40 (depreciation of plant and equipment). The effect of this formulation is to exclude many classes of assets:

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- intellectual property;
- trading stock;
- land;
- buildings and the like which qualify for deductions for capital works under Division 43;
- investment expenditure subject to special regimes in parts of the Act other than Division 40; and
- assets subject to the special rules in Division 40 for some kinds of expenditure, such as certain primary production and mining expenditure.

In a change from past practice, cars can qualify for the investment allowance as well as other assets that might be described as household-type property, even though used in a business (although these may be eliminated by the expenditure threshold below).

- The asset must be new (in the sense of not second-hand) as was the case for the previous investment allowances. What may be different is the inclusion of “new expenditure on existing assets.” The Press Release clearly states that this expenditure qualifies, but almost immediately seems to backtrack stating that “assets that have previously been used or held for use will be excluded.” However, overall, it seems that if a taxpayer spends an amount on an existing asset which qualifies for capital allowances under Division 40 and meets the other tests below, then the investment allowance will be available for that incremental expenditure. This will mainly affect improvements or additions to existing assets, as repairs generally receive an immediate deduction and so do not get capital allowances under Division 40.
- The asset must be used in Australia, as was the case in the past. The idea underlying the allowance is to encourage new investment in Australia which in turn is likely to produce Australian employment. This test creates issues in particular for ships and planes that are used in part outside Australia. If the test is written in similar terms to the previous investment allowances, there are some ATO rulings (now withdrawn) which may (or may not) give guidance on how strictly this test is to be applied.
- The asset must be used for a taxable purpose, usually the earning of assessable income. This requirement is a general one for Division 40 and so in one sense is covered by the first point above. There is, however, an important change from previous practice which required that the asset be used “wholly and exclusively” for taxable purposes. This test created problems where there was some slight disqualifying use. There will be no “wholly and exclusively” test on this occasion as the Press Release deals with cases where use is only partly for taxable purposes.
- A minimum expenditure threshold of \$10,000 applies, apparently on a per-asset basis rather than a per-taxpayer basis. This will presumably eliminate its application to multiple low cost assets such as laptops,

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furniture, etc. There were similar, though lower, thresholds for the 1970-1980s version of the investment allowance.

Which taxpayer qualifies for the investment allowance?

The taxpayer who qualifies for the capital allowance under Division 40 will also be entitled to the investment allowance.

It seems that this condition applies to leased assets and so the lessor will obtain the investment allowance where it also enjoys the Division 40 capital allowance. This will be of interest to asset financiers.

Previous versions of the investment allowance had extremely complex rules for leasing situations. There are still a number of special regimes dealing with leasing of equipment etc, and to the extent that these rules disqualify the Division 40 capital allowance or shift it to another taxpayer, the fate of the investment allowance will, it seems, follow suit.

When must investment occur to obtain the allowance and when can it be claimed?

The investment allowance is available this time around with much shorter windows than in the past. The usual kind of transition rule will apply, that is, the taxpayer will qualify if the contract to purchase the asset was entered, or the construction of a self-constructed asset commences, after the critical time which is midday on Saturday 13 December 2008 and before midnight on 30 June 2009.

The asset must be installed ready for use (that is, must be able to be used even if not actually used in the business) by 30 June 2010 which means that construction of very large assets may have difficulty meeting the timetable.

Capital allowances under Division 40 commence when the asset is installed ready for use. The investment allowance will be claimed in the same tax return when capital allowances under Division 40 are first available. This means that the allowance will be claimable in the 30 June 2009 or 30 June 2010 year depending on which year the asset is installed ready for use.

The start and end dates are "hard" dates and will also apply to taxpayers with substituted accounting periods.

What else may be expected, based on past precedent?

A number of changes to past practice for investment allowances have been noted above. However, the Press Release is entirely silent on many qualifications and restrictions that were found in previous regimes. In particular, there were integrity rules designed to deal with short term

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holdings or the use of assets to generate entitlement to the investment allowance.

The short time frames involved for the new investment allowance, and the robustness of the general anti-avoidance rule in Part IVA nowadays, may mean that similar rules will not be adopted this time around.

The short time frame also means that we may not see the legislation implementing the investment allowance until it is almost over, which suggests at the very least the wisdom of checking with government before committing to large expenditures.

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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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