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Investment Allowance

The Investment Allowance provisions are now law. Make sure you act now to maximise your bonus deduction.

Background

You may have already heard about the Small Business and General Business Tax Break also referred to as the temporary investment allowance ("the allowance"). This has been the subject of much discussion and publicity in recent months. The allowance is targeted toward new investment that will boost business investment and build confidence in the Australian economy in the face of the global recession.

On 19 March 2009 a Bill was introduced in to Parliament to enact the allowance measures. The Bill amends the income tax law to provide a temporary bonus income tax deduction (of 10 per cent or 30 per cent) for new investment in tangible depreciating assets undertaken between 13 December 2008 and 31 December 2009.

On 12 May 2009, the Treasurer announced in his budget speech, the allowance would be increased to 50 per cent for small business entities that make an investment in an eligible asset before 31 December 2009.

The modified Bill received Royal Assent on 22 May 2009.

This article outlines the key concepts contained in the Act and some practical observations and opportunities.

Eligibility

Investment Time

To be eligible for the allowance, an investment in an eligible asset needs to be made between 13 December 2008 and 31 December 2009 ("the investment time"). A taxpayer is considered to have made an investment in an eligible asset where they:

- Entered into a contract under which they hold the asset or will start to hold it at some point in time; or
- Started to construct the asset; or
- Started to hold the asset in some other way.

Therefore, it is sufficient to enter into a contract to acquire an eligible asset between the investment time to qualify for the allowance, even though the taxpayer may not have paid for or taken delivery of the asset.

A taxpayer that chooses to self-construct an eligible asset may also qualify for the allowance. The taxpayer has "started to construct" an eligible asset when they first incur expenditure in respect of the construction of the asset or the modifications to an existing asset.

A taxpayer needs to have invested in an eligible asset between the investment time. This requirement cannot be circumvented by refreshing a contract entered into before 13 December 2008. However, if a taxpayer exercises an option to acquire an eligible asset in the investment time, this will qualify. This will be the case regardless of when the option was created or acquired.

Eligible Assets

To be eligible for the allowance, the asset must be a tangible 'depreciating asset' for which a deduction is available under section 40-25 of the Income Tax Assessment Act 1997. There are prescriptive rules to determine who is entitled to a deduction. However, this is generally the taxpayer who "holds" the asset.

A tangible depreciating asset is defined as an asset with a limited effective life that can reasonably expect to decline in value over time. It is important to note all intangible depreciating assets are excluded from the allowance (e.g. computer software).

The following table summarises the assets which may be eligible and those which are not:

Eligible	Not Eligible
<ul style="list-style-type: none">▪ Tangible depreciating assets for which a deduction is available under section 40-25, including:<ul style="list-style-type: none">Cars - except those using the "cents per kilometre" method.▪ Tangible depreciating assets used by small business entities and allocated to a pool.▪ Tangible depreciating assets used in R&D.	<ul style="list-style-type: none">▪ Intangible assets, such as computer software and intellectual property rights.▪ Cars using the "cents per kilometre" method.▪ Land and trading stock.▪ Capital works, including buildings, construction expenditure and earthworks.▪ Water facilities.

Investment in New Assets

The allowance is available for “new” assets. An asset is “new” for the purposes of the allowance if it has never been used or installed ready for use by any taxpayer. This means that second-hand assets are not eligible for the allowance.

However, an asset will still be considered to be “new” if it has only been used for the purpose of reasonable testing and trialling. For example, demonstrator vehicles can qualify as “new” assets provided they have only been used for reasonable testing and trialling.

New Investment on Existing Assets

The allowance also applies to new investment on existing assets, where that expenditure is of a capital nature. Amounts relating to such assets are treated in the same manner as amounts relating to new assets, although these amounts will usually be included in the second element of the asset’s cost base.

New Investment Threshold

To qualify for the allowance, the investment amount must exceed the relevant new investment threshold. The new investment thresholds are:

- \$1,000 for small business entities; and
- \$10,000 for all other taxpayers.

Small Business Entity

A taxpayer is a small business entity for an income year rather than at a point in time.

A taxpayer is a small business entity for the current income year if they carry on a business in that year and:

- they carried on a business during the previous income year and their aggregated turnover for that year was less than \$2 million; and/or
- it is likely that their aggregated turnover is to be less than \$2million for the current income year.

To qualify for the lower “new investment threshold”, a taxpayer needs to be a small business entity for the income year in which they undertake new investment in an eligible asset, put that asset to use, or to claim the allowance.

New Investment Amount

In determining whether the relevant new investment threshold has been met, the following points should be followed:

- The investment threshold is generally applied for each individual asset. Investments across a number of unrelated assets cannot be aggregated for the purpose of meeting the threshold.
- For jointly held assets, all interests in the asset are recognised for the purpose of meeting the relevant threshold.
- Only capital amounts are included. This is generally the cost to hold the asset (e.g. purchase price, installation costs) and any other costs incurred after purchasing the asset to bring it to its present condition (e.g. a new tray and canopy that is added to a Ute after purchase).
- Amounts that are outright deductible cannot be included (e.g. general repairs and maintenance).
- Multiple investments in the same, individual asset may be aggregated in meeting the new investment threshold. The investments need not be in the same year provided the allowance has not already been claimed on a previous amount.
- Once the threshold has been met in relation to an individual asset, the allowance will be available for all subsequent investments in the asset that are completed on or before 31 December 2009.
- The investment amounts must be GST exclusive.

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Batches and Sets of Assets

Notwithstanding the general rule, a taxpayer is permitted to aggregate investment in assets that are identical, or substantially identical, and in assets that form a set for the purposes of meeting the threshold.

The taxpayer will still need to consider each asset individually. The assets forming the "batch" or the "set" still need to be new tangible, depreciating assets and the criteria around the timing of an investment in each asset still applies. That is, aggregation across batches and sets of assets only applies for threshold purposes.

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

The concept of a set requires more than one depreciating asset. In some cases, however, more than one item makes up a single depreciating asset. An example would be a three volume dictionary. This is a single depreciating asset, not a set of three separate depreciating assets as the three volumes have a single integrated function. Similarly, a computer - consisting of a hard drive, monitor and mouse - would not be considered to be a set, as it forms a single composite asset (with the components naturally aggregated for threshold purposes).

Principle Use and Put To Use

Principal Use

The allowance will not be reduced for any non-business use of the asset. However, a taxpayer must be able to demonstrate that at the time they started to use the asset or had it installed ready for use, the asset was to be principally used in Australia and for the principal purpose of carrying on a business. Therefore, the allowance is not available to taxpayers who do not carry on a business (e.g. employees). There is still no specific guidance on what is "principal use".

The allowance will not be clawed back for any subsequent non-business use provided that the "purpose test" was genuinely satisfied at the time the entity started to use the asset or had it installed ready for use.

Put To Use

To be eligible for the allowance, the eligible asset must be "put to use" by 31 December 2010. An eligible asset will be "put to use" when:

- For investment in new assets, the entity starts to use the asset or has it installed ready for use.
- For new investment in second hand assets, the asset is brought to its changed condition or location (and so included in the asset's second element of cost).
- These concepts are also relevant in determining the timing and therefore, the quantum of the allowance.

Tax Planning Opportunities

The following may serve to assist taxpayers to get the maximum benefit from the allowance:

- For eligible assets, can these be installed ready for use prior to 30 June 2009? Assuming the taxpayer is eligible, this will provide a 30 per cent deduction (50 per cent for small business entities) for the investment in the asset in the 30 June 2009 year.
- For non small business entities, can the 30 per cent deduction be preserved by entering in to a contract to acquire an eligible asset before 30 June 2009? There is no requirement to pay for or take delivery of the asset before 30 June 2009. Provided the asset is installed ready for use prior to 30 June 2010, a 30 per cent deduction will be available in that year.
- The cut off date for eligible assets to be installed ready for use is 31 December 2010. This may be a consideration for long-term construction projects.

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- Consider documentation requirements. Given timing is critical for the allowance, it will be necessary to establish when you were committed to the investment. For example, is there is a written contract to acquire an eligible asset or is it just a verbal agreement? You may also consider how you will establish that you have satisfied the "purpose test" when an eligible asset is installed and ready for use.

Claiming the Allowance

The income year that the allowance can be claimed and the rate to be used in calculating a taxpayer's bonus deduction depends on when the new investment is undertaken and when the new or modified asset is put to use.

Small Business Entity

A small business entity is entitled to a 50 per cent bonus deduction in relation to an asset where:

- The investment is made between 13 December 2008 and 31 December 2009;
- The \$1,000 new investment thresholds has been met; and
- The asset is used or installed ready for use by 31 December 2010.

The following table summarises the timing of the 50 per cent bonus deduction:

	New Investment Between
Installed By	13 Dec 08 - 31 Dec 09
30 June 2009	50% in 2008-09 tax return
30 June 2010	50% in 2009-10 tax return
31 December 2010	50% in 2010-11 tax return

The bonus deduction is available in the year the asset is "put to use".

All Other Entities

10 per cent

In order to qualify for the 10 per cent bonus deduction in relation to an asset:

- The investment is made between 13 December 2008 and 31 December 2009;
- The \$10,000 new investment thresholds needs to be met; and
- The asset is used or installed ready for use by 31 December 2010.

30 per cent

In order to qualify for the 30 per cent bonus deduction in relation to an asset:

- The investment is made between 13 December 2008 and 30 June 2009;
- The \$10,000 new investment thresholds needs to be met; and
- The asset is used or installed ready for use by 30 June 2010.
- For investments made prior to 30 June 2009 but "put to use" between 1 July 2010 to 31 December 2010, a 10 per cent deduction is available.

Again, the bonus deduction is available in the year the eligible asset is "put to use".

The amount of the deduction, based on the timing of the investment and installation date is summarised in the table below:

	New Investment Between	
Installed By	13 Dec 08 – 30 Jun 09	1 Jul 09 - 31 Dec 09
30 June 2009	30% in 2008-09 tax return	-
30 June 2010	30% in 2009-10 tax return	10% in 2009-10 tax return
31 December 2010	10% in 2010-11 tax return	10% in 2010-11 tax return

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Effect of Claiming the Allowance

The allowance represents an up front deduction to the taxpayer. This is calculated by multiplying the GST exclusive investment amount by the relevant percentage. Because it is a deduction, the actual after cash benefit of the allowance is the bonus deduction multiplied by the taxpayer's tax rate.

For example, assume a company purchases a car with a GST exclusive value of \$30,000 and it is entitled to a 30 percent bonus deduction. The company claims a bonus deduction of \$9,000 (\$30,000 x 30%). The cash benefit of this to the company is \$2,700, being the bonus deduction multiplied by the company tax rate (\$9,000 x 30%).

The allowance is not refundable so it may only apply to reduce a taxpayer's taxable income. If a taxpayer is in a tax loss position, the allowance is still available and may apply to increase the carry forward tax loss.

The allowance will not impact on a taxpayer's depreciation deductions in relation to the asset. That is, the taxpayer will claim depreciation on the asset as they would normally. Additionally, there are no adverse effects on disposal of an asset for which a taxpayer was entitled to the allowance. It does not affect the asset's capital gains tax cost base and critically, it does not reduce the adjustable value of the asset for the purpose of calculating a balancing adjustment.

Other Considerations

Some other considerations include:

- Are you claiming the R&D tax concession on depreciating assets? Interestingly, the allowance is also available for eligible assets claimed using the R&D tax concession.
- Do you allow your employees to salary package benefits? Have you considered how the allowance may be available for the benefits being packaged?
- If there are numerous financing options, consider how you may finance the acquisition of an eligible asset to ensure you are entitled to claim the allowance.

- The allowance will be available to you where you are the "holder" of the eligible asset. If you acquire an eligible asset under a hire purchase agreement or a finance lease, you will generally be the "holder" of the asset and eligible for the allowance, subject to satisfying the other requirements.
- The lessor will be the "holder" under an operating lease arrangement. While you (as lessee) may not be eligible for the allowance, the lessor may be eligible. There may be an opportunity to negotiate the terms of the lease if this is the case.
- Do you sell eligible assets which may entitle your customers to the allowance? If you fall in to this category, there may be an opportunity to consider how to incorporate this in to your advertising/marketing campaign. However, appropriate qualifications should be made when considering this. This may include a statement to the effect "your eligibility for the investment allowance will be dependent on your personal circumstances".

Act Now

Now that the investment allowance rules are law, there is only a short time to act to take advantage of these generous concessions.

For small business entities, the key cut off date for making an investment is 31 December 2009. For all other entities to be entitled to the 30 per cent deduction, you must have made an investment on or before 30 June 2009. After this time, the maximum bonus deduction is 10 per cent.

If you have any questions about the investment allowance, please call your William Buck advisor.

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