

## Investment Allowance

As you may be aware, as part of its "Nation Building" initiative, the Rudd Government announced on 12 December 2008 the introduction of a temporary Investment Allowance. Broadly, the Investment Allowance offers a significant one-off tax benefit for certain capital expenditure in respect of 'depreciating assets', where the taxpayer commences to hold the asset under a contract entered into between 13 December 2008 and 30 June 2009 (or where the taxpayer commences to construct the asset between those dates).

The Investment Allowance as initially announced provided an **additional** 10 per cent tax deduction for the cost of purchasing new 'depreciating assets', and on new expenditure enhancing existing 'depreciating assets' where the cost of the asset or the new expenditure is at least \$10,000.

**On 3 February 2009 the Rudd Government announced an increase in the additional tax deduction to 30%. Further, the Investment Allowance was extended beyond 30 June 2009 to allow a 10 per cent deduction for assets (costing \$10,000 or more) acquired between 1 July 2009 and 31 December 2009, provided it is installed ready for use by 31 December 2010.**

This deduction will be in addition to the normal tax 'depreciation' deductions able to be claimed in relation to such assets.

For example, if a qualifying item of plant is acquired for \$100,000, the taxpayer will claim a one-off Investment Allowance deduction of \$30,000 when the asset is first used or installed ready for use, and also deduct (as 'depreciation') the total cost of the plant (\$100,000) over the effective life of the plant.

To be entitled to make a claim, the asset must be used in Australia in a business carried on for the purpose of deriving assessable income, and the asset must be used or installed ready for use by 30 June 2010 (or 31 December 2010 for assets acquired between 1 July 2009 to 31 December 2009).

Since the concession is to be provided as an additional benefit to the existing 'depreciation' concession, the Investment Allowance will not be available for the purchase of trading stock or improvements to land which are not treated under the tax law as 'depreciating assets' (but which may be deducted under the structural improvement capital allowance provisions). The requirement that the asset be a tangible asset also means that intangible assets which may qualify for 'depreciation' as a 'depreciating asset' (such as 'in-house software', patents, copyright, registered designs and mining, prospecting and quarrying rights / information ) will not qualify for Investment Allowance.

A more detailed analysis of the proposed Investment Allowance is in the Attachment to this letter.

In the absence of any legislation, our analysis is based largely on our experience with such incentives introduced by previous Governments. Our comments therefore will need to be reviewed when the enabling legislation is introduced.

### **Opportunities**

- It will be important to consider whether there is any capital spend on tangible depreciating assets that is being considered for future years, that can be established under a contract (or start to be constructed) prior to 30 June 2009. These assets need to be used or installed and ready for use by 30 June 2010.
- To the extent that particular expenditure of less than \$10,000 can be demonstrated to relate to improving or creating a larger functional unit, it may be possible in some cases to group such expenditure with other expenditure relating to the asset such that it meets the \$10,000 threshold for new expenditure to an existing asset, and therefore be eligible for Investment Allowance.
- The purchase of 'composite assets' will need to be considered to determine whether any component is a separate asset with a cost that is less than \$10,000 and thus not eligible for Investment Allowance.
- It would appear, based on the available information, that the Investment Allowance will extend to tangible depreciating assets first held for resource exploration purposes (in addition to being able to be claimed as an immediate depreciation deduction).

### **Information Requirements**

It will be important that appropriate systems are in place to ensure that all qualifying expenditure is accurately captured. Taxpayers will also need to ensure that sufficient documentation exists to support their claims, as Investment Allowance claims are likely to be considered as part of any future Australian Tax Office compliance reviews.

In this respect, it will be necessary to consider whether your existing accounting / tax system will be able to identify / track:

- (a) The date at which contracts have been entered into for the acquisition of individual assets.
- (b) The date at which construction activity began on particular assets.

- (c) The date relevant assets were first used or installed ready for use (i.e. to prove that assets subject to the Investment Allowance have been used or held ready for use by 30 June 2010/31 December 2010).
- (d) The tax character of acquired assets (i.e. whether the asset is a 'depreciating asset' as opposed to being a structural improvement to land or simply expenditure which can be deducted under the tax law, such as under the 'project pool' rules).

Where such information is not readily available, it may be necessary to establish systems that will capture and document the relevant information.

The Investment Allowance offers organisations a significant one-off tax benefit. Given that this benefit only applies to expenditure incurred within a small window of time, organisations will need to be in a position to capture and document the relevant information as soon as possible, in order to ensure maximum benefits are realised.

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**ATTACHMENT**

**Overview of proposed Investment Allowance**

On 12 December 2008 the Federal Treasurer announced the immediate introduction of an Investment Allowance aimed at boosting economic activity in the short term. The aim of this incentive as stated by the Treasurer in his announcement ("Statement") is to boost business confidence and encourage business investment. The Investment Allowance was extended by a further announcement on 3 February 2009.

Whilst the full details of the Investment Allowance have not been released, and the legislation to implement the Treasurer's announcement will not be introduced into Parliament until next year, this Attachment considers certain aspects of the proposed Investment Allowance that are based on the Statement, and identifies potential areas of dispute with the Commissioner of Taxation that may be gleaned from disputes in respect of claims made by taxpayers under previous Investment Allowance regimes. Whether these issues will be relevant under the proposed Investment Allowance regime will need to be considered when the Bill containing the proposed measures is introduced into Parliament.

*What is the proposed Investment Allowance?*

It is proposed that the Investment Allowance will be provided in the form of a tax deduction equal to 10 or 30 per cent of the cost of new assets and new expenditure on existing assets, which are used in Australia ("eligible assets"). Assets that have previously been used or held for use will be excluded. The actual rate will depend on when the asset is acquired/constructed as follows:

**TABLE 1**

Contact Date / Commencement of construction	Installed / Ready for use by	Investment Allowance deduction %
13 December 2008 -30 June 2009	30 June 2010	30
1 July 2009 – 31 December 2009	31 December 2010	10

*How does the Investment Allowance link with depreciation deductions?*

This deduction will be in addition to other deductions available for the 'decline in value' ("depreciation") of the asset under Division 40 of the Income Tax Assessment Act 1997 (ITAA 1997). The extension of the Investment Allowance to expenditure on existing assets means that costs of enhancing 'depreciating assets' where the expenditure is added to the cost of an existing asset under Division 40 (as 'second element' costs) can qualify as an 'eligible asset'.

The Investment Allowance deduction will be available to the taxpayer entitled to depreciation in respect of the 'eligible asset' under Division 40. The person entitled to depreciation under Division 40 is the person who is taken under those provisions to 'hold' the asset. For example, in the case of a 'partnership asset', because it is the partnership that is entitled, as the 'holder', to depreciation, (and not any particular partner), it would be the partnership that is entitled to the Investment Allowance (assuming that the asset is an 'eligible asset'). In the case of joint venture arrangements, whether an asset is a 'partnership asset' (or alternatively whether each venturer holds a specified share of an asset) will be an issue in determining the taxpayer entitled to the deduction.

In the case of leased assets, if the lessor is the 'holder' of the asset under Division 40, then the lessor will be the taxpayer entitled to claim the Investment Allowance. From discussions with the Department of Treasury, there will be no ability (as there was under previous regimes) for a lessor who is a 'holder' of an asset under Division 40, to transfer the right to the deduction for the Investment Allowance to the lessee. In the case of a lease of a 'luxury car', it is the lessee who is the 'holder' of the luxury car under Division 40.

*Use of the asset in Australia*

With respect to the requirement that the asset be used in Australia, it is unclear from the Statement whether, as was the case with previous Investment Allowance regimes, there will be a requirement to use the asset 'wholly and exclusively' in Australia for a minimum period (under previous regimes a twelve month period applied). A requirement to use the assets 'wholly and exclusively' in Australia would clearly be an important issue to consider where the asset is 'transportable' or crosses borders, and any claim for Investment Allowance in respect of assets such as ships, boats and planes, would, if the law includes this requirement, likely be the focus of detailed scrutiny by the Australian Taxation Office ("ATO"), to determine the location of use of the asset. However, if the ATO was to apply its previous administrative practice (i.e. with respect to previous Investment Allowance regimes) when considering whether an asset is 'wholly and exclusively' used in Australia, it may well be that mere isolated use of an asset outside Australia will not disqualify the taxpayer from making a claim. The actual wording of the legislation and any statements made in 'explanatory material' placed before Parliament when the provisions are enacted will influence the approach that will be taken by the ATO with respect to this requirement.

*What is an 'eligible asset'?*

An asset (including 'second element' expenditure in respect of an existing asset) will only be eligible for Investment Allowance where the following are satisfied:

*(a) Monetary threshold*

The expenditure for acquisition (or enhancement in the case of 'second element' expenditure) must be at least \$10,000. Under this test, it will be necessary for the taxpayer to identify what is the asset. In the case for example where a taxpayer purchases 'packaged items' for an amount exceeding \$10,000, the issue to be considered will be whether the 'package' is an asset, or alternatively whether the 'package' is made up of a number of assets each with a cost which is less than \$10,000. In the latter case, there would be no entitlement to the Investment Allowance. In considering this issue, generally the function and purpose of particular items would need to be considered in isolation to other items.

*(b) Asset used in business for taxable purpose*

The asset must be used in carrying on business for the purpose of deriving assessable income ("taxable purpose"). Where an asset is partly used for private purposes or purposes other than a taxable purpose, only the portion that is used in carrying on a business for a taxable purpose will count toward meeting the threshold. The requirement that assets be used 'in carrying on a business' mean that activities of a taxpayer which do not amount to a 'business' (such as the mere holding of investment properties) will not entitle the taxpayer to claim the Investment Allowance in respect of the purchase of an asset to be used in that activity.

*(c) Timing*

The taxpayer must start to 'hold' the asset under a contract entered into per the relevant times set out Table 1, or start to construct the asset between those times. As mentioned above, the requirement to be the 'holder' of an asset, will be governed by Division 40 of the ITAA 1997.

With respect to the requirement that the taxpayer must start to 'hold' the asset under a contract entered into between the dates specified above, or must commence to construct the asset during that time, taxpayers will need to review arrangements which straddle the two dates. Under previous regimes, the ATO has been alert to arrangements designed to alter contracts so as to qualify for the concession. In the case of constructed assets, determining the exact date that construction commenced may present problems in practice. In some cases taxpayers will need to consider whether activities carried out

before 12.01am AEDT 13 December 2008 amount to the commencement of construction activities, or alternatively, are simply regarded as activities preparatory to construction.

*(d) For use by 30 June 2010 / 31 December 2010*

The asset must be used or installed ready for use by the end of 30 June 2010 or 31 December 2010. The words 'installed ready for use' are a defined term in the ITAA 1997 and mean "installed ready for use and held in reserve". Under this test, whilst an asset may well be installed ready for use if the asset is simply ready to be physically used, it has been held that the words 'held in reserve' go much further and generally require that the asset be held ready to be applied in an existing business to cover a contingency such as the breakdown of another asset.

*(e) New asset expenditure*

The asset must be a 'new asset' and expenditure on existing assets must be 'new expenditure'. There is no guidance in the Statement as to what will be regarded as a new asset, but the further requirement that the assets must not have previously been used or held for use, will clearly exclude what may be termed as second hand goods, and also goods that have been installed for use although not actually used.

*(f) Tangible asset requirement*

The asset must be a 'tangible asset' for which a deduction is available under the 'core provisions' of Division 40 of the ITAA 1997). These are 'depreciating assets' that qualify for capital allowances under subdivision 40-B, but the requirement that the asset be a 'tangible asset' means that the following assets will be excluded:

- mining, quarrying or prospecting rights or information
- patents, copyright or registered designs (including licences)
- 'in-house software'
- an indefeasible right to use a telecommunications cable system
- 'spectrum licences'
- 'datacasting transmitter licences'
- 'telecommunications site access rights'.

Since the asset must be a tangible asset to which Division 40 applies, an asset which is trading stock will not qualify for Investment Allowance, nor will land (including improvements to land to which Division 43 of the ITAA 1997 applies). The difficulty in differentiating between those assets to which Division 40, as opposed to Division 43, applies is an existing point of contention as between the ATO and taxpayers, and introduction of the Investment Allowance will no doubt escalate this issue as an area of

potential dispute with the Commissioner.

With respect to the requirement that the asset needs to qualify for capital allowances under subdivision 40-B, it is noted that if any other subdivision of Division 40 applies, then the Investment Allowance will not be available. The reason for this is that other subdivisions of Division 40 already provide concessionary tax treatment. Thus for example, a 'depreciating asset' which is either a 'water facility' or a 'horticultural plant' will not qualify.

#### *Motor vehicles*

Notably there is no exclusion from the proposed Investment Allowance regime for 'cars', with the Treasurer's Statement in fact confirming that the benefit will be available for cars used in carrying on business. Specifically, the Treasurer notes in his Statement that a car will not be disqualified from the Investment Allowance merely because the taxpayer does not claim deductions for decline in value under Division 40 of the ITAA 1997, but instead elects to claim deductions for use of the car under the '12 per cent of cost method'. Perhaps the current problems facing the car industry has prompted Government to not exclude cars from the concession (as was the case with previous regimes).

#### *When can the Investment Allowance be claimed?*

The Investment Allowance can be claimed through the income tax return of the taxpayer for the year in which the first 'capital allowance' (under Division 40) is claimed for the asset. Since these Division 40 deductions can only be made from when the asset is first used or is 'installed ready for use', simply incurring the cost will not entitle the taxpayer to make a claim for the Investment Allowance. The asset will need to be used or 'installed ready for use'. Comments on what are meant by 'installed ready for use' are set out above.

#### *Use by others*

Previous Investment Allowance regimes have included a provision that disqualifies the taxpayer where within twelve months of acquiring the asset, the asset is disposed of, or the holder allows the asset to be used by another party. There is nothing in the Statement which suggests that the proposed regime will include a similar provision, but that possibility cannot be discounted. Much of the litigation between the Commissioner and taxpayers with respect to previous regimes concerned this very issue, and specifically, whether arrangements entered into by taxpayers with respect to assets which otherwise qualified for the concession, had the effect of giving another party the right to use the asset.

*Conclusion*

The comments above are based on the Statement made by the Treasurer about a proposed law that will need to be passed by Parliament and also on our experience in advising on previous Investment Allowance regimes. Until the law is enacted, the entitlement of any taxpayer to claim a deduction cannot be ascertained. The comments made in this Attachment will need to be reconsidered having regard to the legislation as enacted, and the facts applying to the particular circumstances.

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