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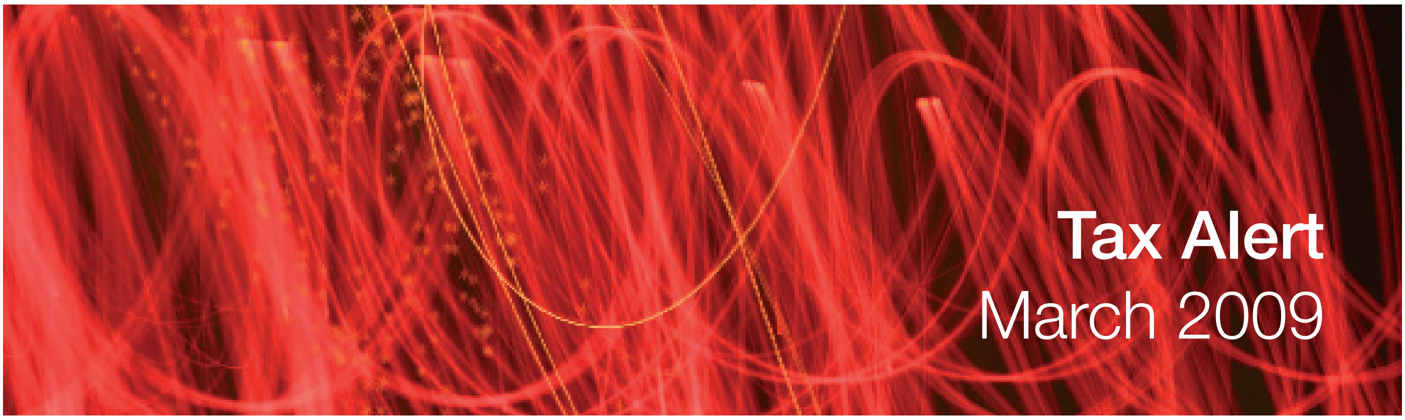

The Investment Allowance is here
Now.........what does it really mean?

On 19 March 2009 a bill to enact the new *investment allowance* measures was introduced to Federal Parliament.

"This is good news for machinery, heavy equipment and motor vehicle manufacturers and distributors as well as their customers. It is also likely to have a significant impact on year end activity for a number of industries including transport and haulage, wineries and agriculture, fishing and aquaculture and the mining industry to name a few. Property developers and their commercial tenants involved in substantial "fit outs" are also likely to be significantly affected by these measures."

The *Tax Laws Amendment (Small Business and General Business Tax Break) Bill* 2009 (**Bill**) has been introduced to Parliament. The investment allowance or "small business and general business tax break", as it is referred to in the Bill, will provide a 30% or 10% deduction (depending on the acquisition and installation rules) for taxpayers who acquire tangible, depreciating assets within the established timeframes. This is good news for machinery, heavy equipment and motor vehicle manufacturers and distributors as well as their customers. It is also likely to have a significant impact on year end activity for a number of industries including transport and haulage, wineries and agriculture, fishing and aquaculture and the mining industry to name a few. Property developers and their commercial tenants involved in substantial "fit outs" are also likely to be significantly affected by these measures.

This Alert will review the proposed legislation and raise some of the pitfalls and planning issues associated with these measures.

All statutory references below are to the *Income Tax Assessment Act* 1997 (**1997 Act**).

Basic features

The new measures are temporary. They only provide deductions for the 2009, 2010, 2011 and 2012 income years.

The measures (as contained in the Bill) may be summarised as follows:

> Taxpayers who acquire eligible assets after 12 December 2008 but before 30 June 2009 will be eligible for a 30% deduction on the cost of the asset provided the asset is installed ready for use by 30 June 2010;

> Taxpayers who acquire eligible assets after 30 June 2009 but before 31 December 2009 should be eligible for an equivalent 10% deduction provided the asset is installed ready for use before 31 December 2010;

> The asset must be a tangible, depreciating asset and must be acquired for the principal purpose of carrying on a business;

> The expenditure incurred in acquiring the asset - or bringing the asset into its present condition - must exceed $10,000 for general taxpayers or $1,000 for small business entities (taxpayers with an annual turnover of less than $2M);

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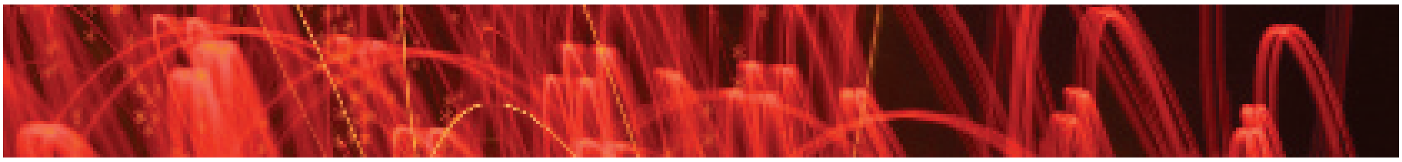

> The deduction will be in addition to the usual capital allowance deductions available for the acquisition and use of depreciating assets;

> The deduction will not affect the adjustable (or tax written down) value of the asset. Therefore, it will be possible for a taxpayer to claim in excess of 100% of the cost of the asset in deductions over the asset's effective life;

> There will be no balancing adjustments on account of deductions claimed under the investment allowance upon the resale of the asset – this is a very significant concession;

> There will be no apportioning of the deductions between business and private use. The taxpayer need only satisfy the requirement that the asset when first used or installed ready for use, had the principal purpose of carrying on a business.

It should be noted that whilst entirely new legislation is proposed (new division 41), the measures will draw heavily on many of the existing concepts for claiming capital allowance deductions.

What is an eligible asset?

Only assets that meet the existing definition of a "depreciating asset" qualify. Under section 40-30 of the 1997 Act, a "depreciating asset" is an asset that has a limited effective life and can reasonably be expected to decline in value over the time it is used.

The definition explicitly excludes:

> land;

> trading stock; and

> intangible assets.

"Intangible assets" comprising of specific forms of intellectual property are normally not affected by this exclusion for intangible assets. However, under the Bill only tangible assets qualify for relief. Therefore, acquisitions of intellectual property will not be eligible. It is also worth stressing that only new investments qualify – second hand depreciating assets are ineligible. At the same time, new expenditure on second hand assets may potentially qualify if the expenditure meets the threshold criteria.

There is a limited category of assets that do not qualify for deductions under division 40 but may still qualify for the investment allowance.

These include:

> cars where the taxpayer claims car expense deductions using the 12 percent of original value method;

> assets in which small business entities (formerly known as STS taxpayers) can claim capital allowance deductions under subdivision 328-D; and

> tangible, depreciating assets that qualify for research and development deductions.

The ability to claim a further 30% deduction on research and development expenditure is significant as a 125% or 175% deduction may already be available through the existing provisions.

Who may claim the investment allowance?

Only a "holder" may claim the investment allowance. The holder is the entity that is normally eligible for capital allowance deductions. This term was introduced in 1 July 2001 to replace the previous formal requirement that only the owner of plant could claim depreciating deductions (with various dispensations given by the Commissioner under public rulings).

Given the significance of the "holder" concept, the table in section 40-40 of the 1997 Act has been duplicated in its entirety on the following page:

Item	This kind of depreciating asset:	Is held by this entity:
1	A luxury car in respect of which a lease has been granted	The lessee (while the lessee has the right to use the car) and not the lessor
2	A depreciating asset that is fixed to land subject to a quasi-ownership right (including any extension or renewal of such a right) where the owner of the right has a right to remove the asset	The owner of the quasi-ownership right (while the right to remove exists)
3	An improvement to land (whether a fixture or not) subject to a quasi-ownership right (including any extension or renewal of such a right) made, or itself improved, by any owner of the right for the owner's own use where the owner of the right has no right to remove the asset	The owner of the quasi-ownership right (while it exists)
4	A depreciating asset that is subject to a lease where the asset is fixed to land and the lessor has the right to recover the asset	The lessor (while the right to recover exists)
5	A right that an entity legally owns but which another entity (the economic owner) exercises or has a right to exercise immediately, where the economic owner has a right to become its legal owner and it is reasonable to expect that: (a) the economic owner will become its legal owner; or (b) it will be disposed of at the direction and for the benefit of the economic owner	The economic owner and not the legal owner
6	A depreciating asset that an entity (the former holder) would, apart from this item, hold under this table (including by another application of this item) where a second entity (also the economic owner): (a) possesses the asset, or has a right as against the former holder to possess the asset immediately; and (b) has a right as against the former holder the exercise of which would make the economic owner the holder under any item of this table; and it is reasonable to expect that the economic owner will become its holder by exercising the right, or that the asset will be disposed of at the direction and for the benefit of the economic owner	The economic owner and not the former holder
7	A depreciating asset that is a partnership asset	The partnership and not any particular partner
8	Mining, quarrying or prospecting information that an entity has and that is relevant to: (a) mining operations carried on, or proposed to be carried on by the entity; or (b) a business carried on by the entity that includes exploration or prospecting for minerals or quarry materials obtainable by such operations; whether or not it is generally available	The entity
9	Other mining, quarrying or prospecting information that an entity has and that is not generally available	The entity
10	Any depreciating asset	The owner, or the legal owner if there is both a legal and equitable owner

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It is evident that there are a wide range of potential situations covered in the above table that will require careful scrutiny to ensure the taxpayer qualifies as a holder.

Significantly, in many cases there will be more than one holder. This does not mean both parties will be entitled to the investment allowance or a portion of it. In these circumstances, it is important to bear in mind that the entity's deduction is normally based on the cost they have incurred when they start to hold the asset (or bring the asset into its present state or condition). Therefore, whilst the entity claiming the investment allowance must be a holder, they must also bear the cost of acquiring (or constructing) the asset.

Real property as an eligible asset

As noted already, land is specifically excluded from the definition of a depreciating asset. However, section 40-30(3) of the 1997 Act deems an improvement to land or a fixture on land to be a separate asset from the land. Therefore, fixtures or improvements may potentially qualify.

However, two matters must be considered here:

> Such items must meet the existing definition of a depreciating asset being an asset with a limited effective life which is reasonably expected to decline in value over the time it is used;

> Such items cannot be building or structures or other assets that qualify for the existing capital works deductions (generally 2.5% of the construction expenditure) under division 43 of the 1997 Act.

The latter requirement in particular is likely to lead to some difficult characterisation issues in relation to the fit out of buildings. The distinction made by the courts over the years has been between those items that merely amount to "an income producing setting" or the "fabric of the building" and those items traditionally regarded as "plant". For instance, whilst items such as air conditioning systems and lifts may be regarded as depreciating assets (and eligible for division 40 deductions) other fixtures such as gas and sewage plumbing and mains will generally be regarded as part of the building (only eligible for division 43 capital works deductions).

There is likely to be a renewed interest in this distinction particularly given the significantly improved tax position of claiming the 30% or 10% investment allowance (in addition to the usual capital allowance deductions for the item's effective life) rather than the 2.5% amount available as a capital works deduction.

It can be expected that property developers and tenants of new or refurbished commercial buildings will need to carefully consider the nature of improvements being effected to ensure they maximise the entitlement to the investment allowance. Taxpayers already engaged in or proposing large scale fit outs may also have a significant incentive to bring forward installation deadlines so as to fall within the timing requirements for the investment allowance.

Timing is critical

As noted already, the deductions will only be available for the 2009, 2010, 2011 and 2012 income years.

To claim the investment allowance, the taxpayer must have:

> acquired or started to hold the eligible asset;

> met the relevant "new investment threshold" (i.e. $1,000 for small business entities or $10,000 for other taxpayers); and

> used the asset or installed it ready for use.

Precisely when the taxpayer satisfies the above requirements is critical in determining whether the taxpayer obtains a 30% deduction or a 10% deduction (or no deduction at all). These timing issues are reasonably complicated. They may be broadly summarised as follows:

> if a taxpayer acquires an eligible asset before 30 June 2009 which exceeds the relevant new investment threshold, the taxpayer may claim a 30% deduction on the expenditure in either the 30 June 2009 or 30 June 2010 income year;

> the year in which the taxpayer is entitled to the 30% deduction will depend on when the asset is installed ready for use;

> if the taxpayer installs the asset ready for use before 30 June 2009, then the 30% deduction may be claimed in the 30 June 2009 income year;

> if the asset is installed ready for use after 30 June 2009 but before

30 June 2010, the 30% deduction may be claimed in the 30 June 2010 income year;

> if the taxpayer fails to install the asset ready for use by 30 June 2010, but installs the asset before 31 December 2010, only a 10% deduction may be claimed in the 30 June 2011 income year;

> if a taxpayer acquires an eligible asset after 30 June 2009 but before 31 December 2009 which exceeds the relevant new investment threshold, the taxpayer may claim a 10% deduction on the expenditure in either the 30 June 2010 or 30 June 2011 income year;

> again, the deduction is claimed in the income year in which the eligible asset is installed (with the final cut-off date for installation being 31 December 2010).

The following table, extracted from the explanatory memorandum of the Bill, illustrates these principles:

	New Investment 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

The term "installed ready for use" is not defined in the Bill or the existing legislation. However, in ATO Interpretative Decisions ATOID 2007/116 and ATOID 2003/552 the Commissioner has accepted that the term "use" in the context of division 40 requires the employment of the asset in such a way that it can be reasonably expected to decline in value. Thus, an asset is "installed ready for use" where the asset is in a position to be "used" in this manner.

The Bill uses the concept of "investment commitment time" to determine the period in which the taxpayer must satisfy the "new investment" threshold. The investment commitment time is generally when the taxpayer:

> entered into a contract to start to hold the asset; or

> started to construct the asset.

It is expected that ordinary contract law principles will determine when a taxpayer has entered into the relevant contract. The contract will, of course, often not be reduced to writing. It will therefore be critical that systems are in place to ensure invoices, purchase orders and other source documents and records are available to substantiate that the taxpayer entered into the contract within the relevant timeframes.

Contracts with suppliers will need to be carefully drafted to ensure that the relevant use and installation dates are met.

Treatment of Motor Vehicles

For profitable businesses, the next few months may be an ideal time to upgrade the fleet of motor vehicles used in the business.

In relation to cars, it should be noted that, taxpayers adopting the "12% of original cost" method may still qualify for the investment allowance notwithstanding this method does not allow for capital allowance deductions under division 40. Other methods available under division 28 also qualify for the investment allowance but not the "cents per kilometre" method. Division 28 only applies to individuals or a partnership involving individuals. All other taxpayers should be eligible to claim the investment allowance provided the car (or other motor vehicle) meets the definition of a depreciating asset and the other threshold requirements for claiming the investment allowance.

It is also important to note that the luxury car limit ($57,180 for the 2009 income year) restricts the deduction available for luxury cars.

As mentioned earlier, the investment allowance may be claimed notwithstanding there is some private use, provided the principal use at the time the taxpayer starts to use/hold the asset ready for use is for business purposes. This is expected to be significant for car acquisitions where there is often an element of private use.

There is nothing in the Bill that "claws back" the benefit of the investment allowance if the car (or other depreciating asset) does not continue to be used principally for business purposes. The explanatory memorandum to the Bill confirms this is an intended design feature. At the same time, any substantial private use of a car subsequent to the acquisition may suggest the car was not acquired principally for business use in the first place. Care should therefore be taken on any car acquisition where a mixed-use is involved.

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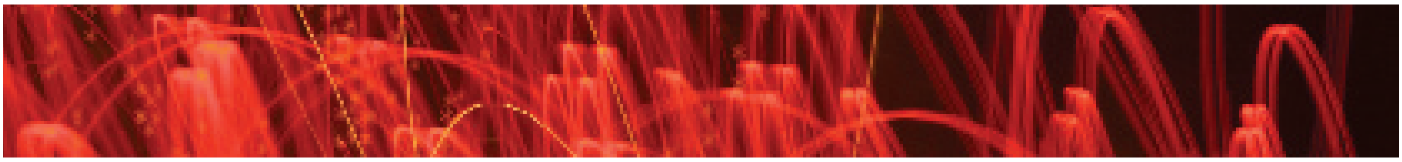

Planning issues and other observations

There are a number of practical as well as technical issues that need to be considered and these matters will need to be monitored as the Bill progresses and ultimately becomes law.

Some of the issues that should be considered are as follows:

> Many taxpayers will have settled their 2009 budgets at around 30 June 2008. For taxpayers in capital intensive industries, these will need to be reviewed including an evaluation of the funding needs and operational issues associated with accelerating the timing of the investments. This re-prioritising and review of budgets will equally apply to taxpayers with their income year ending 31 December as such taxpayers will have settled their budgets well before the investment allowance was announced.

> Given the short time available between placing the order and having the asset installed ready for use, care should be taken to ensure that the asset will be used or installed ready for use by the required date. Those industries that normally close down before Christmas holidays will obviously need to plan to use or install the asset ready for use well before the 31 December 2009 and 31 December 2010 deadlines.

> If existing depreciating assets are being replaced, accelerating the installation of the new eligible asset could also mean accelerating further deductions where the existing assets are scrapped or treated as obsolete. The timing of when such balancing adjustment deductions are generated will need to be carefully considered to ensure anticipated outcomes.

> As noted already, commercial properties and other major building developments involving substantial improvements will need to be given special consideration in terms of the value attached to the depreciating assets (as opposed to improvements to the building or structure itself) and the time of installation of the depreciating assets.

> Taxpayers purchasing technical equipment or devices should strive to ensure that the substance of what they are purchasing is the physical equipment rather than any intellectual property (eg copyright in the technical manuals, specifications etc) provided with the equipment. The investment allowance is available for tangible assets only and with certain acquisitions the distinction between whether the acquisition is tangible or intangible may be less than clear.

> Any taxpayers that are already in a tax loss position (or that may enter a tax loss position on account of expenditure incurred in claiming deductions under the investment allowance) will need to be mindful of the carry forward company and trust loss measures. It will be critical to ensure that the benefit of the deduction has not been compromised for when the taxpayer returns to a tax positive position and wishes to recoup its losses.

Commercial issues for suppliers: misleading and deceptive conduct

Taxpayers involved in the manufacture, distribution and sales of machinery, motor vehicles and other eligible assets are likely to experience significant sales activity in the lead up to the various deadlines. These companies can be expected to launch significant advertising campaigns to promote their products in light of the tax benefits. Businesses should, however, be cautious about advertising material they release to ensure that it does not leave them liable for actions of misleading and deceptive conduct under the *Trade Practices Act* 1974 or the equivalent state legislation.

The use of appropriate qualifications including that the application of the measures is highly dependent on the customer's circumstances is strongly recommended.

Where to from here?

It is important to note that only a Bill has been released at this stage and that some change may be expected in the process of the draft legislation being enacted. Thomson Playford Cutlers will be closely monitoring the progress of these measures and related developments.

We have experience in providing specialist tax advice in capital allowances across a range of industries and will be able to assist you with practical and helpful advice in this area. For significant and complex acquisitions, it is highly recommended that tax "sign off" is obtained. Where the position is less than certain a "reasonably arguable position" should be established to manage the tax risk associated with claiming the investment allowance.

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