

ABCD

Tax
10 Shelley Street
Sydney NSW 2000

P O Box H67
Australia Square 1213
Australia

ABN: 51 194 660 183
Telephone: +61 2 9335 7000
Facsimile: +61 2 9335 7001
DX: 1056 Sydney
www.kpmg.com.au

Small Business and General Business Tax Break
Consultation
Mr Matthew Flavel
The Treasury
Langton Crescent
PARKES ACT 2600

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Contact Matthew Hayes (02) 9335 7503
Jenny Wong (02) 9335 8661

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Dear Matthew

Exposure draft legislation of the Tax Laws Amendment (Small Business and General Business Tax Break) Bill 2009 - KPMG submission

We thank you for the opportunity to comment on the exposure draft legislation, *Tax Laws Amendment (Small Business and General Business Tax Break) Bill 2009* (the ED).

The Government's proposal to introduce a temporary investment allowance is an important initiative aimed at boosting business confidence in the current economic environment and has been welcomed by many of our clients.

We believe legislation needs to be introduced into Parliament and passed as soon as possible to provide taxpayers with the legislative certainty needed to enter into and complete commercial transactions.

Generally, from our review of the ED, we have identified areas that may need further refinements. For example, we believe the provisions in the ED need to address our issues relating to the following:

- Taxpayers with substituted accounting periods. Legislative refinements may be needed to ensure the provisions are consistent with the Government's announcement of 3 February 2009.
- Expanding scope of eligibility for taxpayers, particularly in relation to taxpayers with 'sets of assets'.
- Clarifying certain provisions either legislatively or further commentary in the explanatory memorandum (EM), particularly regarding the 'investment time'.

We also recognise there are a number of issues peculiar to equipment financiers and we understand those issues will be addressed in the submission prepared by the Australian Equipment Lessors Association.

Whilst adopting some of the recommendations set out in our submission ensures certain commercial transactions undertaken by taxpayers are covered, thereby enhancing the provisions to ensure the investment allowance is relevant for these taxpayers, we also appreciate Treasury needs to introduce this legislation into Parliament as soon as possible.

If Treasury considers it is important to address these issues, but believes addressing these issues may take some time, then consideration should be given to extending the eligible period by, for example, six months.

If the eligible period is not extended, Treasury will need to ensure the Australian Taxation Office (ATO) is involved early on in the development of the investment allowance legislation such that interpretive guidance may be provided to taxpayers as soon as legislation becomes law (and ideally as soon as the Bill is introduced into Parliament).

1 Taxpayers with a substituted accounting period

Because of the 'hard dates' imposed in the ED in relation to 'investment time' and 'first use time', the outcome for certain early balancers and late balancers appears to be inconsistent with the Government's press release of 3 February 2009. Examples where this might arise are highlighted below.

A *Early balancers*

Consider an early balancing taxpayer with 31 December income year in lieu of the 30 June income year.

The 2010 income year for this taxpayer would end on 31 December 2009. To be able to access the 30% investment allowance deduction, the investment time must occur before 1 July 2009 and the 'first use time' in relation to the asset must end no later than 31 December 2009. However, according to the press release, taxpayers were allowed access to the 30% rate if the asset was installed ready for use by 30 June 2010. Thus, under the current drafting of the provisions in the ED, the taxpayer has a six month timing disadvantage in accessing the 30% investment allowance rate.

Similarly, for a taxpayer with an income year ended 31 March 2010 (early balancer, in lieu of 30 June), the investment time needs to occur by 30 June 2009 and first use time needs to occur by 31 March 2010 to obtain access to the 30% investment allowance rate. This is notwithstanding the press release suggesting taxpayers have until 30 June 2010 to have their assets installed ready for use to gain access to the higher investment allowance rate.

Recommendation

We recommend the draft provisions be amended to allow access to the 30% rate for certain early balancing taxpayers that will have a first use time no later than 30 June 2010 (and an investment time occurring before 1 July 2009).

B Late balancers

Consider a late balancing taxpayer with a 30 September income year in lieu of the 30 June income year.

For this taxpayer, the 2009 income year would be the income year ended 30 September 2009. If the investment time occurred after 1 July 2009 but before 30 September 2009 and the first use time occurs by 30 September 2009, it would seem the 30% investment allowance is available for this taxpayer. However, the press release suggests the investment time must occur by 30 June 2009.

Recommendation

We understand from a discussion with Treasury, this may not be the intended outcome. We recommend the provisions in the final law be clarified if this is not the intended outcome.

2 Scope of assets qualifying for the investment allowance deduction

A Sets of assets

The ED provides the current threshold tests for small and general business be looked at on an asset-by-asset basis (Section 41-135). Paragraph 1.10 of the EM clarifies the threshold applies on a per asset basis (although multiple investments relating to the same asset may be amalgamated in meeting the new investment threshold). For example, if under one contract, a taxpayer orders 10,000 items of plant costing \$500 each, the depreciable asset would not qualify for the investment allowance.

For commercial reasons, taxpayers may purchase a number of functionally similar depreciable assets in bulk, for example, to obtain a discount or alternatively, there is a need for more than one asset to ensure a structure may be brought to a state where it can be fully functional.

Some examples that are commonly bought in sets include:

- The purchase of computers for a business.
- The purchase of sets of seats for a new theatre or refurbished theatre (rather than repair of a single seat).
- Furniture in hotels as part of refurbishment programs.

These capital investments may, or may not, involve the identification of separate assets under an order.

Recommendation

Expanding the scope of the investment allowance entitlement to taxpayers that purchase sets of assets that amount to greater than \$10,000 for general business (or \$1,000 for a small business entity), although individually are less than \$10,000 (or \$1,000 for a small business entity), would be consistent with the stated objective of the new proposals: “to provide a temporary business tax break for Australian businesses with a view to encouraging business investment and economic activity”. This would also be in line with commercial practice when ordering functionally similar assets that are part of an overall equipment upgrade by a business.

An alternative solution is to lower the asset threshold for each individual item, for example, \$500 per individual asset.

B Imported assets used first time in Australia

Generally, the proposed investment allowance deduction is available in relation to assets used for the first time (Section 41-120(1)(e)). In addition, the asset must be used in Australia or installed ready for use in Australia for the principal purpose of carrying on a business.

On an initial reading of the ED, it would appear that equipment imported into Australia from overseas does not qualify for the proposed investment allowance. Paragraphs 1.39 and 1.40 of the EM clarify this requirement:

The Tax Break aims to provide a stimulatory effect to the economy by encouraging the acquisition of assets which have not been used in the economy previously.

An asset is ‘new’ for the purposes of the Tax Break if it has never been installed ready for use before either by the taxpayer or another entity for any purpose, anywhere prior to 12 December 2008. This means that second-hand assets are not eligible for the Tax Break.

It would seem that importing second hand equipment means that the asset is not used for the first time and therefore, the investment allowance deduction is not available.

A taxpayer may look offshore to acquire a depreciating asset in carrying on its business due to the absence of a local market for the asset. However, because the asset is not ‘new’, the investment allowance deduction is not available. There is a question as to whether there is a compelling policy reason for excluding imported second hand equipment used for the first time in Australia from the new investment allowance proposal.

Recommendation

We recommend Treasury consider extending the scope of eligible assets to imported second hand assets that are used for the first time in Australia.

3 Other technical issues

A Investment time

In determining whether an investment allowance deduction is available and the applicable rate, a taxpayer needs to determine the ‘investment time’ under Section 41-125 of the ED.

In relation to an amount that is included in the first element of the asset’s cost (generally, for new assets), Section 41-125(1)(a) provides the ‘investment time’ is generally the time at which the taxpayer:

- Enters into a contract under which you hold the asset at that time, or will hold the asset at a later time (s41-125(1)(a)(i)); or
- Start to construct the asset (s41-125(1)(a)(ii)); or
- Start to hold the asset in some other way (s41-125(1)(a)(iii)).

If the amount is included in the second element of the asset’s cost, the ‘investment time’ is generally the time at which the taxpayer enters “into a contract or commence construction, for the economic benefit in relation to which the amount becomes, or will become, included in that element”.

There is some uncertainty on which ‘investment time’ prevails if more than one ‘investment time’ applies.

For example, consider the following:

- A taxpayer may enter into a contract before 13 December 2008 for a third party contractor to construct an asset on the taxpayer’s premises and under the taxpayer’s control, but the actual construction commences after that date. In this example, the taxpayer may be considered to have entered into a contract under which it “will hold the asset at a later time” (i.e. s41-125(1)(a)(i) is satisfied). This date occurred *prior* to 13 December 2008. However, in this example, the taxpayer may also be considered to construct the asset. This time occurred *after* 13 December 2008. Clearly, this example illustrates that the investment time may be either before 13 December 2008 or after 13 December 2008. Similar uncertainty could also arise where contracts are entered into and commencement of construction spans 30 June 2009 or 31 December 2009.

- A similar issue arises in relation to existing depreciating assets that are refurbished and where expenditure is included in the second element of the asset's cost. There may be a contract entered into in relation to "the economic benefit in relation to which the amount becomes, or will become, included in that element under paragraph 40-190(2)(a)" before the relevant date with construction commencing after the relevant date.

The inclusion of a clarification as to what is the "investment time" would be preferable as it would provide taxpayers with certainty where Sections 41-125(1)(a)(i), (ii) and (iii) can all be satisfied in relation to the one arrangement. Given the intention of the investment allowance is to encourage expenditure, it would appear appropriate that the taxpayer is able to choose the most favourable investment time.

Also, as discussed above, a key issue in determining the relevant investment time is whether a taxpayer holds the asset under a contract (the acquisition case) or constructs the asset (the construction case).

This issue has been considered by the courts and the Commissioner in relation to previous investment allowances (for example, refer the Commissioner's views in *Income Tax Ruling IT 2142*). These decisions and the Commissioner's previous ruling highlight the potential uncertainty in relation to whether the acquisition case or construction case should apply.

Further, there is limited, if any, guidance in the ED or EM on this key issue. In particular, example 1.21 in the EM involves consideration of the relevant investment time. However, this is a very simple example without any discussion or analysis of whether the acquisition case or construction case would apply.

Given this is a key issue for many businesses, it may be helpful to include further examples in the EM in relation to the acquisition case and construction case, to provide additional certainty to taxpayers in making investment decisions.

Recommendation

In light of the above, it would seem appropriate to:

- Clarify what is the "investment time" where Sections 41-125(1)(a)(i), (ii) and (iii) can all be satisfied in relation to the one arrangement; and
- Provide further examples in the EM in relation to the acquisition case and construction case.

B Intangible assets

Section 41-105 of the ED excludes intangible assets from the scope of the new investment allowance proposals.

Examples 1.1 and 1.7 of the EM clarify that software is an intangible asset and therefore not eligible for the investment allowance.

However, under the former IT 26 *Computers – depreciation, investment allowance*, the view expressed for the purposes of the former investment allowance provisions was that software sold as an integral part of the computer system, would form part of the computer system that is subject to depreciation and the investment allowance.

This principle would seem to be reasonable and would avoid doubt under the new investment allowance proposal.

Recommendation

We recommend the EM contain examples to clarify that software sold as an integral part of the computer system would form part of the computer system for depreciation and investment allowance purposes. Treasury could expand the current Examples 1.1 and 1.7 of the EM to clarify that software that is an integral part of a new computer purchased would qualify for the investment allowance.

C Section 41-120(1)(e) – clarification needed

There seems to be a technical issue in relation to the wording in Section 41-120(1)(e) of the ED.

Generally, the investment allowance is available where there is a ‘recognised new investment amount’. Under Section 41-120(1), a recognised new investment amount includes, inter alia:

(e) If the amount is included in the first element of the asset’s cost – the first use time for the amount is the first time you or any other entity have used the asset, or have it installed ready for use, for any purpose

There have been issues raised in relation to the drafting of this provision. For example, if a taxpayer purchased the depreciable asset from a vendor that treated the asset as trading stock, it would seem (e) might be satisfied because the provision requires the asset be the “first time you or any other entity have used the asset, or have it installed ready for use for any purpose”. From the vendor’s perspective (being the “other entity”) it held the asset for trading stock purposes which might fit in the “any other purpose” part of the provision. For the purchaser, it is the “first time” the taxpayer used the depreciable asset, irrespective of the fact the vendor used the asset for trading stock purposes.

Another possible interpretation of this provision is that the acquisition of second hand equipment satisfies Section 41-120(1)(e) because it is the “first time” the taxpayer uses the second hand equipment. However, this interpretation is inconsistent with the EM.

Alternatively, if the provision used words such as “the asset is used for the first time” then this would suggest only new items are eligible for the investment allowance, which is consistent with the comments in the EM and the press release of 3 February 2009.

Recommendation

We recommend the wording in Section 41-120(1)(e) be clarified to reflect the policy intent. We also recommend clarification in the EM to confirm that assets held as trading stock by the ‘other entity’ would not preclude a taxpayer from obtaining the investment allowance deduction.

D Tax consolidated groups and the single entity rule

There is no discussion in the EM on how the investment allowance applies in certain scenarios involving tax consolidated groups or multiple entry consolidated (MEC) groups.

For example, consider a tax consolidated group comprising of A & B. A acquires a depreciable asset under contract prior to 13 December 2008 and holds it as trading stock. It subsequently sells the asset to B, a member of the same tax consolidated group, and the asset is a depreciating asset of B.

Our analysis is that prima facie, the transaction would need to be considered from the tax consolidated group perspective such that Section 70-110 of the ITAA 97 applies in this scenario. Because A, which held the asset as trading stock, sells the asset to B, which holds the asset as depreciating asset, there is a change in the asset’s use. As a result, Section 70-110 applies such that there is a deemed disposal of the asset and a reacquisition of that asset for the asset’s cost. The time at which the asset stops being trading stock would seem to satisfy the criteria in Section 41-125(1) i.e. the tax consolidated group “started to hold the asset in some other way”. (Note: The reason why Section 41-125(1)(a)(i) does not apply is because the contract between A and B would, from the tax consolidated group’s perspective, be a contract the group enters into with itself. Section 41-125(1)(a)(i) would seem to only apply where contracts are entered into with third parties).

Recommendation

If Treasury agrees with this interpretation, then clarification should be incorporated in the EM to provide taxpayers with certainty.

E Joint venture interests

The application of the investment allowance is based on the operation of Division 40 of the ITAA 97. In relation to unincorporated joint ventures which do not constitute tax partnerships, Section 40-35 has the effect that each joint venture participant’s interest in the underlying asset is considered to be its underlying asset for the purposes of Division 40.

Consider the following example:

Mining joint venture has three joint venture participants with the following ownership interests: A owns 85%, B owns 7% and C owns 8%. The joint venture invests \$100,000 in a new piece of equipment within the relevant investment and installation timeframes.

The application of Section 40-35 would result in A owning an asset worth \$85,000, B owning an asset worth \$7,000 and C owning an asset worth \$8,000. Taxpayer's B and C would therefore not qualify for the investment allowance given that their investment does not exceed the new investment threshold (notwithstanding the acquisition of the new equipment had a cost well exceeding the \$10,000 threshold amount). Each joint venturer's contribution was necessary in acquiring the new equipment.

Given the intent of the investment allowance is to stimulate the economy, it would appear inconsistent to deny minority joint venturers the investment allowance.

Recommendation

We recommend the current ED be amended to modify Section 41-135 such that the new investment threshold test is applied disregarding Section 40-35 of the ITAA 97.

The same amendment should also apply to recognised new investment amounts resulting in a second element of cost for jointly held assets on the same grounds.

F Depreciating assets under Subdivision 40-F of the ITAA 97

Generally, taxpayers are allowed to deduct amounts for capital expenditure on depreciating assets that are water facilities under Subdivision 40-F of the ITAA 97. A water facility is defined to include plant that is primarily and principally for the purpose of conserving or conveying water. This includes water piping and other equipment which is being used to conserve water. For example, piping is used to reduce water wastage as a result of open waterways.

The law currently allows one-third of the expenditure on water facilities to be deductible in the year in which it is incurred and one-third in each of the following two years. The EM to the bill introducing Subdivision 40-F stated the accelerated depreciation was a concession designed to encourage primary producers to undertake expenditure on water management to increase their capacity to withstand drought and to improve their on-farm water management.

The benefit received under this Subdivision 40-F is merely a timing difference, as opposed to a permanent difference offered by the investment allowance deduction.

Recommendation

It would therefore seem reasonable to extend the investment allowance to depreciable assets covered under Subdivision 40-F. The investment allowance would also assist to accelerate investments in infrastructure designed to conserve water.

ABC

G Mutual entities

Mutual entities may acquire an asset that is used in a taxable and a non-taxable business. It is unclear from the ED and the EM whether mutual entities will be entitled to the investment allowance deduction.

Recommendation

We recommend an example to be included in the EM to confirm whether mutual entities are entitled to the investment allowance deduction.

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Should you wish to discuss any of the above further, please do not hesitate to contact us.

Yours sincerely



Matthew Hayes
Tax Partner

Yours sincerely



Jenny Wong
Director