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TAXATION INSTITUTE *of* AUSTRALIA
IT'S ESSENTIAL

10 March 2009

Small Business and General Business Tax Break – Consultation
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email investmentallowance@treasury.gov.au

Dear Sir

Draft Tax Laws Amendment (Small Business and General Business Tax Break) Bill 2009

The Taxation Institute of Australia ('Taxation Institute') is pleased to provide its comments on the draft *Tax Laws Amendment (Small Business and General Business Tax Break) Bill 2009* ('draft Bill)', released for public comment on 25 February 2009.

The Taxation Institute supports the general thrust of the draft Bill in providing eligible small businesses with:

- an additional 30 per cent tax deduction for eligible assets costing $1,000 or more that they acquire from 13 December 2008 to 30 June 2009, and install by 30 June 2010; and
- an additional 10 per cent deduction for eligible assets costing $1,000 or more that they acquire from 1 July 2009 to 31 December 2009, where they are installed by 31 December 2010.

In considering the measures contained in the draft Bill, we raise the following issues for your consideration. The focus of our comments is to ensure the draft Bill appropriately supports the objectives for the introduction of Division 41 outlined by the Prime Minister and the Minister for Small Business on 3 February 2009 and our intention is not to add unnecessarily to complexity or compliance costs.

1. Intangible assets

The deduction is currently limited to "tangible" depreciating assets and excludes intangibles such as software, intellectual property rights and other intangible assets (paragraph 41-105(1)(a)). However, the Taxation Institute would support the inclusion of certain intangible assets within the scope of the deduction on the basis that such investment is stimulatory and supports those businesses in the business of providing such intangibles.

It is our strong view that such intangibles include a certain percentage or value of Australian labour (such as implementation and/or training) and that such expenditure would be consistent with the general thrust of the Government's purpose for introducing these provisions. As announced jointly by the Prime Minister and the Minister for Small Business on 3 February 2009, the measures are intended to help Australian businesses boost business investment, bolster economic activity and support Australian jobs.

By way of example, the majority of Small Business and Medium Enterprises (SMEs) operate their business on an IT Platform of one form or another. The current economic climate may in many circumstances encourage business to review and improve/update their IT Platform. This will inevitably involve an investment in one or more of the following:

- hardware;
- software applications; and
- training and ongoing support.

Each aspect of the above elements causes a stimulatory effect, in particular the provision of ongoing training and support by service/product providers. The availability of a one-off tax break (such as this measure) may well be the critical factor in businesses deciding to proceed with such an undertaking. There is little doubt that it would benefit and support economic growth and employment in Australia.

2. Grouping of assets

Under section 41-105 the deduction is referable to a depreciating asset and this applies on a per asset basis. We believe this limitation is inequitable in certain instances and should be amended to include ‘like’ or ‘same’ assets as a single asset for the purposes of these provisions.

By way of example, a business which decides to replace or upgrade their computer and information technology hardware (and software) may be ineligible for a deduction under the proposed provisions if each individual asset had an installed cost of less than the applicable threshold. Equally, some assets on an individual basis may qualify and others not. Whereas, on a ‘like’ or ‘same’ asset test basis, the whole installed cost may qualify if it is in excess of the relevant threshold.

Such eligibility may well be a critical factor in the decision by an eligible business to undertake such expenditure. Equally, most if not all businesses would regard the type of expenditure outlined above as a ‘single’ commercial outgoing as part of a new and/or upgraded information technology platform. The Taxation Institute thinks that such an approach is reasonable in all of the circumstances and should be reflected in the final form of the Bill.

3. Potential clawbacks

The Taxation Institute is concerned that there are at least two possible instances where the potential benefit under the draft Bill can be clawed back by other tax provisions.

3.1 Capital gains tax

There is the potential for the benefit obtained by taxpayers under these proposed provisions to be clawed back (in full or part) through the application of CGT Event E4 (section 104-70 ITAA 1997). In this regard we recommend that the relevant provisions in S.104-70(1) be amended to disregard the share of trust net income that is subject to these new provisions.

3.2 Division 41

There is the potential for the benefit obtained by taxpayers under these proposed provisions to be clawed back (in full or part) if the taxpayer is a company and the payment of an unfranked or partially franked dividend occurs as a result of a claim under the proposed Division 41. This could be addressed through the allowance of a franking credit to the company franking account equal to the Division 41 claim multiplied by the prevailing company tax rate.

The Taxation Institute recognises and understands that the above two suggested changes require amendments to other provisions to the ITAA 1997, which may not be the intention or preference in introducing the proposed Division 41. However these new provisions have been promulgated on the basis of delivering a permanent tax break (bonus income tax deduction).

4. Impact on the non-commercial loss rules

It would appear that a deduction claimed under the proposed Division 41 rules is subject to the quarantining rules set out in *Division 35 – Deferral of losses from non-commercial business activities* ITAA 1997. In other words, if a claim under Division 41 causes a taxpayer to have deductions that exceed income from the business activity, then the net loss is quarantined (in circumstances where if the expenditure had not occurred the net loss would not have been quarantined).

The Taxation Institute believes this is an unintended consequence of Division 41.

We would propose that Division 35 provisions provide an exclusion for Division 41 deductions such that they are ignored when assessing compliance with Division 35 or similar provisions to the effect that any Division 41 expenditure will be deductible irrespective of Division 35 application.

5. New investments

The proposed Division 41 applies to 'new' investments. However, feedback from the Taxation Institute's membership indicates that it is not uncommon for a business to acquire machinery second hand/reconditioned. It would appear discriminatory to exclude such equipment from the extra deduction. Therefore, we recommend that second hand equipment should not be excluded.

As an integrity measure, provision could be included that prevented a claim being made in respect of second hand equipment being acquired from a related party (using the section 318 definition of "associate"). We further submit that if there is a concern with regard to the broader implications of the availability of the deduction to the whole community, consideration could be given to limiting the second hand/reconditioned concession to taxpayers conducting a primary production business

Allowance should also be made for the re-sale of goods returned under warranty which are subject to rectification and/or repair and subsequently resold, unless it is considered that such circumstances are already covered by section 41-120(2).

6. Water facilities

It appears that the proposed Division 41 deduction is not available in respect of water facilities which are claimable under Subdivision 40-F.

Given the high importance of such equipment to farmers, to exclude this equipment from the allowance would appear to be discriminatory. Inclusion of water facilities would in our view, seem to be highly consistent with the stated objective of promoting economic growth and employment in Australia and additionally complement the Government's Climate Change agenda. One option that could be considered in this regard is to enable a taxpayer to elect to claim for these items under subdivision 40-B instead of Subdivision 40-F (thus a lower annual write-off) and be eligible for the Division 41 deduction.

7. Application dates

The Taxation Institute is aware from its Members that there are significant manufacturing operations actually seeking to increase production capacity and are hiring staff to meet an increased demand for their products both locally and worldwide. We consider that the Federal government should extend every assistance they can to taxpayers that are trying to expand and employ new staff.

In the particular instance referred to the Taxation Institute, the entity has placed and is expected to place significant orders worth in excess ofA$20 million for the purpose of expanding their production capacity. Due to the size and complexity of the equipment including cranes, massive curing ovens and factory space expansion, the suppliers of the assets are unlikely to have that equipment installed by 30 June 2010 and will be struggling to have some of that equipment installed by 31 December 2010.

In situations such as this, it is inequitable that these taxpayers be denied the proposed deductions due to factors outside their control. We recommend that the Commissioner of Taxation or the Minister for Industry and Trade be provided with a discretion to extend the deadlines where it is appropriate and equitable to do so. We put forward this as an example of when the discretion ought to be exercised in favour of the taxpayer.

8. Minor amendments

Section 41-135(a) (i) uses the term 'recognised investment amount' whereas it should read 'recognised new investment amount'.

If you require any further information or assistance in respect of our submission, please contact Joan Roberts on 03 9611 0178 or the Taxation Institute's Senior Tax counsel, Dr Michael Dirkis, on 02 8223 0011.

Yours sincerely

Joan Roberts

Joan Roberts
President