THE TAX INSTITUTE

6 August 2021

Grahame Hager
Assistant Commissioner — Law Design and Practice, Tax Counsel Network
Australia Taxation Office
By email: grahame.hager@ato.gov.au

Dear Grahame,

Draft Law Companion Ruling LCR 2021/D1 — Temporary full expensing

The Tax Institute welcomes the opportunity to make a submission to the Australian Taxation Office (**ATO**) in relation to the Draft Law Companion Ruling LCR 2021/D1 — Temporary full expensing (**draft Ruling**). We appreciate the additional time provided to lodge this submission.

We have consulted with our National Technical Committees in the development of this submission to obtain a breadth of views on issues that impact the broader membership of The Tax Institute.

We provide the following comments and recommendations for your consideration to improve the draft Ruling which provides guidance in relation to the application of the provisions for temporary full expensing (**TFE**) of depreciating assets introduced by the *Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Act 2020* and the *Treasury Laws Amendment (2020 Measures No.6) Act 2020* (**JobMaker tax plan legislation**).

Summary

The Tax Institute considers that the draft Ruling should not be finalised in its current form without further amendments. As a general observation, we commend the ATO on the guidance contained within the draft Ruling in relation to the operation and interaction of the relevant provisions. However, there are some aspects of the draft Ruling which require further consideration and amendment prior to the finalisation of the Ruling.

We have set out below a summary of the key items contained in our submission:

- Requesting further clarity to illustrate the interaction of TFE with the instant asset write-off (**IAWO**) and backing business investment (**BBI**) rules;
- Seeking further detail regarding the interaction of the relevant measures and the resulting practical outcomes for taxpayers e.g. the impact on the reduction of the deductible amount by the asset's decline in value that is attributable to non-taxable use under Division 40 where there is a change in the taxable use of an asset during its effective life;
- Seeking clarity in relation to whether the IAWO rules prevail over conflicting statutory provisions in instances where a joining entity's assets are second-hand assets in the head company's hands (for consolidation purposes) or where assets are acquired from associates (outside of the consolidation context);
- Requesting further explanation by way of examples and clarification as to how the TFE measure applies to small business entities (**SBEs**) (that choose simplified depreciation and those that do not, the impact on eligible assets and general small business pools) and in more general scenarios e.g. where a balancing adjustment event occurs within the same income year that TFE would otherwise apply; and

- Recommending a minor amendment to reflect the date of the IAWO rules as effective from 2 April 2019 (rather than 1 July 2019).

We have provided detailed comments in relation to the key issues in **Appendix A**.

The Tax Institute is the leading forum for the tax community in Australia. We are committed to shaping the future of the tax profession and the continuous improvement of the tax system for the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all. Please refer to **Appendix B** for more about The Tax Institute.

If you would like to discuss any of the above, please contact Michelle Ma, Associate Tax Counsel, Tax Policy and Advocacy, on (02) 8223 0084.

Yours faithfully,

Peter Godber
President

APPENDIX A

DETAILED COMMENTS

Background and policy intent

The draft Ruling provides guidance in relation to the application of the provisions for TFE of depreciating assets introduced by the JobMaker tax plan legislation. TFE refers to the immediate write-off of the cost of depreciating assets and relevant additional expenditure in accordance with the rules in:

- Subdivision 40-BB of the *Income Tax (Transitional Provisions) Act 1997* (**IT(TP)A**), applicable to business entities generally; and
- Section 328-181 of the IT(TP)A which modifies the operation of the rules in Subdivision 328-D of the *Income Tax Assessment Act 1997* (**ITAA 1997**), applicable to SBEs choosing the simplified depreciation rules.

We invite the ATO to consider our submission and the proposed amendments put forward to enhance the draft Ruling and ensure clear guidance is provided to the broader community to enable the ATO to achieve its intended purpose for the final Ruling stated as follows:

- To outline the operation of TFE;
- To provide views on interpretive issues;
- To explain the interaction of TFE with the IAWO rules under section 40-82 of the IT(TP)A and the BBI rules under Subdivision 40-BA of the IT(TP)A; and
- To explain and illustrate how TFE applies to SBEs.

Consolidated groups — Joining entity's assets are second-hand assets in the head company's hands

Paragraphs 95 to 98

Paragraphs 95 to 98 of the draft Ruling suggest that subsections 701-55(2)(b)-(e) of the ITAA 1997 (which relate to inheriting the joining entity's method and the effective life for the asset) will not apply where Subdivision 40-BB of the IT(TP)A is satisfied due to the operation of section 40-145 of the IT(TP)A. This section states that Subdivision 40-BB applies in priority to all other provisions to work out the decline in value of a depreciating asset held for an income year.

Outside of the consolidation provisions, there are other provisions which require an entity to adopt the effective life and depreciation method of the transferor in particular, subsection 40-65(2) and subsection 40-95(4) for assets acquired from associates. It would be useful if the final Ruling provided clarification that TFE is available for assets acquired from associates due to the primacy of Subdivision 40-BB.

Unlike Subdivision 40-BB, neither section 40-82 (the IAWO rules) nor Subdivision 40-BA of the IT(TP)A (the BBI rules) have a priority provision similar to the operation of section 40-145 of the IT(TP)A which expressly states that certain provisions will prevail over other provisions (e.g. the normal Division 40 rules). We recommend that the final Ruling should be amended to address whether the IAWO (which can apply to second-hand assets) prevails over subsections 701-55(2)(b)-(e), despite no express provision so that a head company can access the IAWO for assets that are brought into a consolidated group through a joining event.

This would provide greater certainty in relation to the practical outcomes for taxpayers. We acknowledge that resolution of this issue and to determine which provision should prevail would be a matter of statutory construction. In this regard, we refer to the judgment in *Project Blue Sky v Australian Broadcasting Authority* (1998) 194 CLR 355, in particular, paragraph 70 (extract provided below), and the commentary on reconciliation of conflicting statutory provisions, as well as section 701-85 which indicates that section 701-55 can give way to other provisions of the Act.

> “70. A legislative instrument must be construed on the prima facie basis that its provisions are intended to give effect to harmonious goals. **Where conflict appears to arise from the language of particular provisions, the conflict must be alleviated, so far as possible, by adjusting the meaning of the competing provisions to achieve that result which will best give effect to the purpose and language of those provisions while maintaining the unity of all the statutory provisions.** Reconciling conflicting provisions will often require the court "to determine which is the leading provision and which the subordinate provision, and which must give way to the other”. Only by determining the hierarchy of the provisions will it be possible in many cases to give each provision the meaning which best gives effect to its purpose and language while maintaining the unity of the statutory scheme.” (emphasis added)

Accordingly, we are of the view that BBI is not likely to be available due to the blanket exclusion for second-hand assets in Subdivision 40-BA of the IT(TP)A, however, we consider that express clarification on this point is necessary.

Similarly, outside of the consolidation context, The Tax Institute is of the view that it would be helpful if the final Ruling could consider whether the IAWO could apply in priority to subsections 40-65(2) and 40-95(4) where assets are acquired from associates.

Balancing adjustment events

Paragraph 79

Paragraph 79 highlights that if a balancing adjustment event occurs to an asset in the same income year that TFE would otherwise apply (to the first or second elements of the asset’s cost), then TFE will not apply due to the operation of paragraphs 40-160(1)(e) and 40-170(1)(e) of the IT(TP)A. Normally, this would not have any practical consequence as the sale of an asset would result in a large balancing adjustment that reverses the effect of the TFE if it were available. However, the balancing adjustment event under subsection 40-295(2) can apply where there is a minor change in the interest held in a partnership asset (e.g. a 1% partner exits the partnership). Even though subsection 40-340(3) of the ITAA 1997 provides for roll-over relief for the tax implications of such balancing adjustment events, the balancing adjustment event nevertheless is deemed to have occurred in such a situation.

The Tax Institute is of the view that it would be beneficial if the final Ruling contained an example to highlight this outcome which may otherwise not be commonly known to many taxpayers. We suggest an example could be included as follows:

> “*Example [X] – balancing adjustment events in relation to partnership assets*
>
> A partnership acquires a new depreciating asset valued at $100,000 on 1 January 2021 that otherwise qualifies for TFE in the 2020–21 income year.
>
> - On 1 July 2020, prior to the acquisition of the asset, a new partner joined the partnership and acquired a 5% interest. While a balancing adjustment event under subsection 40-295(2) occurs in respect of assets held by the partnership at that time, it does not preclude the partnership from accessing the TFE concession.
> - On 30 June 2021, a different partner exits the partnership and disposes of a 5% interest. As this causes a balancing adjustment event to occur in respect of the asset acquired on 1 January 2021, TFE is not available to the partnership, whether or not roll-over relief under section 40-340 is chosen for the balancing adjustment event.
> - If, however, that partner was to exit the partnership on 1 July 2021, and dispose of a 5% interest, a balancing adjustment event is taken to occur in respect of the asset in a later income year. TFE remains available to the partnership in the 2020–21 income year, and the usual consequences of a balancing adjustment event under Subdivision 40-D of the ITAA 1997 will apply in the 2021–22 income year.”

Backing business investment

Example 9

Example 9 of the draft Ruling seeks to illustrate the interaction of these measures with TFE for a 30 June balancing entity with an aggregated turnover of $100 million for the 2020–21 income year. In respect of the $25,000 improvement cost for Asset B, we consider that it would be useful for the example to expressly state that an 'opt out' of TFE may be available for the $25,000 second element costs and the IAWO may or may not apply, depending on whether the IAWO provisions applied to the initial acquisition (first element costs) of the asset (as per paragraph 40-82(3A)(d)).

Further, we recommend the ATO provide greater clarity to taxpayers beyond 30 June balancing entities (i.e. those with substituted accounting periods) on the application of the rules, including the various acquisition and first held dates for these taxpayers.

Instant asset write-off

We consider that the final Ruling should expressly delineate between the IAWO available to medium and larger businesses under section 40-82 that applies from 2 April 2019, and the original temporary increased IAWO under the simplified depreciation rules for SBEs (provided by section 328-180) that has been available since 12 May 2015, with varying thresholds applicable in different periods, and reverted to $1,000 from 1 January 2021. The express outline of each set of IAWO rules will provide clarity and reduce potential confusion for SBEs and other taxpayers.

Paragraph 109

At paragraph 109, the draft Ruling states that the IAWO applied with effect from 1 July 2019 under section 40-82 of the ITAA 1997. This should be amended to state the IAWO rules applied with effect from 7:30pm (AEDT) on 2 April 2019.

Small business entities and eligible assets (car limit)

Paragraph 127

At paragraph 127, the draft Ruling provides that the car limit in section 40-230 may apply to determine the maximum cost that can be deducted under the simplified depreciation rules. It would be beneficial for the final Ruling to refer to the issue of the car limit earlier within its contents to appropriately address its relevance to all taxpayers who acquire cars, more broadly. The car limit is relevant also to those entities that do not use the simplified depreciation rules (i.e. the car limit applies to also limit the amount of the IAWO, BBI and TFE for non-SBE taxpayers). We invite the ATO to consider also including a direct reference to the car limit for the 2021–22 income year of $60,733 (while retaining the inclusion of the amount of the car limit for 2020–21) either in the paragraph or as a footnote, particularly given the date of issue of the final Ruling.

We consider that the draft Ruling would be further enhanced if it provided an explanation that, even if the actual price paid for the car exceeds $150,000, the car could still be eligible for the IAWO as the deemed cost in section 40-230 overrides the actual cost. As such, the car would qualify for the IAWO despite the $150,000 limit in paragraph 40-82(2A)(e), but only to the extent of the car limit and the taxable purpose evidenced by, for example, the business-use percentage recorded in a logbook.

Small business entity example

Example 10

At paragraphs 130 to 132, the draft Ruling provides an example relating to small business depreciation deductions in the 2020–21 income year. We are of the view that the example could be improved by clarifying how a choice to use the simplified depreciation rules may allow older assets to be written off during the 2020–21 income year.

We recommend amendments to paragraph 130 to state that the entity held depreciating assets with adjustable values (tax written down values) of $250,000 as at 30 June 2020, but that the entity did not use the simplified depreciation rules in the 2019–20 income year (either because it chose not to or was not an SBE for that year). If the entity chose to use the simplified depreciation rules in the 2020–21 income year, all existing depreciating assets (not excluded under subsection 328-175) would be automatically allocated to the general small business pool under subsection 328-185(3), with the adjustable values of those assets becoming the opening pool balance as per section 328-195. As such, $250,000 is available to be written off in the 2020–21 income year as per subsection 328-210(2)(a).

The final Ruling should also explain that this could illustrate when the pool balance could be written off for the 2021–22 income year. The Tax Institute considers that it would be useful for the final Ruling to expressly note the common scenario that many general small business pools were fully expensed under section 328-210 on 30 June 2020 (due to the operation of section 328-180 of the IT(TP)A) in instances where the pool balance was less than $150,000. In many cases, the pool balance would have already been fully deducted in the 2020–21 income year, so there would be no pool balance to deduct in the 2021–22 income year (as no balance would remain in the pool and any new assets acquired during 2021–22 would have been immediately written off rather than added to the pool).

Entities that did not choose to use the simplified depreciation rules in the 2020–21 income year, or were not SBEs in the 2020–21 income year, could bring any assets existing as at 30 June 2021 into the general small business pool and write off the entire pool in the 2021–22 income year if they choose to use the simplified depreciation rules for the first time during the 2021–22 income year.

Furthermore, as outlined in our Joint Bodies submission to Treasury in relation to 'full expensing of depreciating assets and SBE pooling' earlier this year, The Tax Institute is of the view that there is currently some misinformation in the community and across some parts of the profession that a SBE can choose whether to fully expense their pool balance at the end of the income year. Accordingly, the ATO may wish to clarify that, by the operation of the law, if an SBE chooses to continue to apply Subdivision 328-D of the ITAA 1997, SBEs are required to fully deduct their general small business pool balances on 30 June 2021 and cannot choose not to deduct the pool balance.

Assets covered by Subdivisions 40-E and 40-F of the ITAA 1997

At paragraph 44, the draft Ruling outlines that low cost assets (i.e. assets that cost less than $1,000) are not eligible for TFE where the entity has an existing Subdivision 40-E low-value pool.

We consider that it would be useful for the final Ruling to highlight that such assets may be eligible for the IAWO under section 40-82 (if the relevant criteria under that section are met). Subsection 40-425(7A) was inserted in 2020 to effectively switch off the low-value pool for assets that are otherwise eligible for the IAWO. Subsection 40-50(2) is consistent with this, as it applies only to turn off Subdivision 40-B for assets allocated to a Subdivision 40-E software development pool (but not a Subdivision 40-E low-value pool).

This is another example of inconsistent treatment by the various measures of otherwise identical assets that does not seem to have an obvious policy intent behind it and could be worth highlighting in the final Ruling.

Alternative income test

Example 1 – costs of tangible depreciating assets for the purpose of the second condition

At paragraph 35, there is a reference to Footnote 28. The typo in Footnote 28 should be corrected to 'Exposure' rather than 'exposue'.

Other comments

Taxable use of an asset subsequently changes (to a lesser proportion or starts to be used for a wholly private purpose)

The draft Ruling is silent on the interaction of the IAWO, BBI and TFE measures and the reduction for non-taxable use in subsection 40-25(2). While the IAWO, BBI and TFE rules determine the decline in value of the asset for an income year, Subsection 40-25(1) provides a taxpayer with a deduction equal to that decline in value. However, that deduction must be reduced under subsection 40-25(2) to the extent of any non-taxable use. The rules do not require retrospective adjustment to this calculation where there is a subsequent change in the taxable use of a depreciating asset where the adjustable value has been reduced to nil in a prior income year.

Very broadly, where an asset ceases being used, or being installed ready for use, for **any** purpose, a balancing adjustment event occurs. Generally, section 40-285 deals with a change in the 'holding' of the asset or a change in interests in the asset. No balancing adjustment event occurs when there is a mere change in the use of the depreciating asset. However, in our view, reductions to the balancing adjustment amount under section 40-290 somewhat addresses a change in use.

The Tax Institute is of the view that it would be beneficial for the ATO to provide an example to demonstrate the life cycle of an asset in the circumstances where the taxable use subsequently changes (to a lesser taxable proportion), or where it starts to be used for a wholly non-taxable purpose, to highlight the operation of the relevant rules and the potential outcome which may otherwise not be commonly known to many taxpayers.

We suggest an example could be included as follows:

> "*Example [X] – Change in taxable use of an asset and reduction for non-taxable use*
>
> *A business with an aggregated turnover of $40 million acquires a depreciating asset for $100,000 (after claiming GST credits) on 28 June 2021 which qualifies for TFE. It immediately began using the asset for a taxable purpose. The decline in value under the TFE provisions for the 2020–21 income year is $100,000, assuming it is used for a wholly taxable purpose from 28 June 2021. From November 2021, the asset begins to be used 20% for a private purpose. No balancing adjustment event occurs at this time, or in the 2021–22 income year.*
>
> *In a later income year, the business disposes of the asset. Accordingly, the balancing adjustment provisions in Subdivision 40-D of the ITAA 1997 apply.*
>
> *Section 40-290 applies to reduce the amount of a balancing adjustment amount to the extent that the decline in value deductions were reduced under section 40-25(2) because the asset was used for a purpose other than a taxable purpose at any time during the period the asset was held by the taxpayer.*
>
> *As the asset qualified for TFE, and there was no reduction of the decline in value under section 40-25(2) in the year the asset qualified for TFE, there would be no reduction of the balancing adjustment amount under section 40-290(1). Accordingly, the balancing adjustment amount in the later income year is equal to the asset's termination value."*

Furthermore, we observe that the draft Ruling does not expressly articulate:

- how the non-taxable use of a depreciating asset in the year the asset qualifies for TFE affects the calculation of the deduction under Subdivision 40-BB; and
- how the non-taxable use of a depreciating asset in a later income year affects the calculation of the balancing adjustment amount under section 40-290.

The Tax Institute considers that it is necessary for the ATO to provide guidance, where possible, on these interpretative issues to ensure comprehension on how these provisions interact and operate for the relevant taxpayers.

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APPENDIX B

About The Tax Institute

The Tax Institute is the leading forum for the tax community in Australia. We are committed to representing our members, shaping the future of the tax profession and continuous improvement of the tax system for the benefit of all, through the advancement of knowledge, member support and advocacy.

Our membership of more than 11,000 includes tax professionals from commerce and industry, academia, government and public practice throughout Australia. Our tax community reach extends to over 40,000 Australian business leaders, tax professionals, government employees and students through the provision of specialist, practical and accurate knowledge, and learning.

We are committed to propelling members onto the global stage, with over 7,000 of our members holding the Chartered Tax Adviser designation which represents the internationally recognised mark of expertise.

The Tax Institute was established in 1943 with the aim of improving the position of tax agents, tax law and administration. More than seven decades later, our values, friendships, and members' unselfish desire to learn from each other are central to our success.

Australia's tax system has evolved, and The Tax Institute has become increasingly respected, dynamic, and responsive, having contributed to shaping the changes that benefit our members and taxpayers today. We are known for our committed volunteers and the altruistic sharing of knowledge. Members are actively involved, ensuring that the technical products and services on offer meet the varied needs of Australia's tax professionals.