

The Investment Allowance

What it means to small business



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Please note

The material and contents provided in this publication are informative in nature only. It is not intended to be advice and you should not act specifically on the basis of this information alone. If expert assistance is required, professional advice should be obtained.

The Investment Allowance for small business entities

The following information has been developed to assist clients ensure that they can maximise their use of the 'Investment Allowance'. It is for information purposes only and does not cover your individual circumstances. You should seek our assistance before making any decisions based on this guide.

It is likely that the Investment Allowance will be clawed back by the Tax Office where you do not use the asset primarily in the business or where the asset is sold shortly after its purchase without a genuine business case.

The following checklist provides a snapshot of the eligibility criteria for the Investment Allowance. You can find further information on each of the items noted in the reference notes. You need to answer yes to each of the questions to qualify for the Investment Allowance. This guide only relates to entities that carry on business with an aggregated annual turnover of less than \$2 million (referred to as small business entities). Different eligibility criteria and tax consequences apply to business entities with aggregated annual turnover of \$2 million or more.

Investment Allowance eligibility checklist for Small Business Entities

Eligibility	Reference	Yes
The asset was (or will be) purchased by a business that is carried on in Australia.	1	<input type="radio"/>
The asset will be installed ready for use by a business carried on in Australia.	1	<input type="radio"/>
The asset is a tangible asset (i.e. cannot be software, or other assets such as a license or patent) that would normally be eligible for a depreciation deduction.	2	<input type="radio"/>
The asset is new (or only used in a limited trial such as a demonstrator model car).*	3	<input type="radio"/>
The asset is not eligible for special deduction concessions for water facilities, horticultural plants, some land care operations, and trees used in carbon sink forests.**	4	<input type="radio"/>
The asset costs at least \$1,000.***	5	<input type="radio"/>
You must have committed to buy/construct the asset (or make the additional investment) between 12.01am, 13 December 2008 and 31 December 2009.	6	<input type="radio"/>
You must have used the asset or had the asset installed ready for use by 31 December 2010.	7	<input type="radio"/>

* The asset can be an additional investment to improve an existing asset. See item 1 for details.

** The asset cannot already be eligible for deduction concessions under Subdivision 40-F, 40-G, or 40-J of the Income Tax Assessment Act. See item 4 for details.

*** It is possible to combine the cost of identical (or substantially identical) assets and assets that form part of a set in order to meet the expenditure threshold. See item 5 for details.

Eligibility criteria 1 – The purpose test

To claim the Investment Allowance, you must be able to demonstrate that at the time you started to use the asset or had it installed ready for use, it was reasonable to conclude that the asset was going to be used principally in Australia for the purpose of carrying on a business in Australia.

If the asset is used ‘for the principal purpose of carrying on a business’ (i.e. over 50%) then generally, the full Investment Allowance is claimable (but non-business use will limit the normal depreciation deductions available to you).

Example 1.1 – Asset used over 50% in the business

John runs a charter boat business as a sole trader with a turnover below \$2 million.

He purchases a new boat in May 2009 for \$100,000 that will be used 80% in his charter business and 20% for personal use. The new boat is first used in the charter business in June 2009.

John will be entitled to claim the full 50% Investment Allowance in relation to the new boat in the 2008/09 income year (i.e. \$50,000 additional deduction) as the boat is used for the principal purpose of carrying on a business.

The standard depreciation deduction for this boat for the 2008/09 income year would be based on the business use (80%) and the number of days it was ‘used’ in the income year (June 2009).

The asset may be purchased for use in a business that was not operating at the time of purchase (i.e. it can be acquired for a future business). However, the person claiming the Investment Allowance needs to show that, at the time the asset was first used or installed ready for use for any purpose, it is reasonable to conclude they will use the asset in a business carried on in Australia.

Similarly, you can claim the Investment Allowance for an asset purchased for a different business activity to the one currently undertaken by your business as long as you meet the other requirements and the intent is to use the asset in a business carried on in Australia.

Example 1.2 – Asset purchased for use in a different activity to the current business

John currently runs a boat repair business at the local marina. He is considering purchasing 2 boats to begin a charter boat business.

Provided the boats are used primarily in this business (and the other conditions are met), John will be able to claim the Investment Allowance in relation to the boats in the year they are first used or installed ready for use.

Eligibility criteria 2 –Asset must be a ‘tangible’ asset

To claim the Investment Allowance, the asset in question must be eligible for depreciation deductions under Division 40 of the Income Tax Assessment Act 1997 unless it is an intangible asset. Also, to be able to claim a deduction under Division 40, the entity must be the ‘holder’ of the asset. If you have entered into a lease agreement or a partnership, it will be important to make sure that the holder of the asset is the entity claiming the Investment Allowance.

The following assets are NOT eligible for the Investment Allowance on the basis that they are either not depreciable under Division 40 or they have been specifically excluded from being eligible for the Investment Allowance:

- Cars using the ‘cents per kilometre’ method
- Land
- Buildings
- Capital works expenditure (e.g. improvements to buildings)
- Trading stock
- Patents
- Registered designs
- Copyrights
- Licenses
- Software
- Intellectual property
- Water facilities
- Horticultural plants

However, some assets that are not depreciated under Division 40 may still be eligible for the Investment Allowance:

- Cars, where the car expense deduction is claimed under the ‘12 per cent of original value’ method;
- Tangible assets that are depreciated by a small business entity under the special pooling rules; and
- Tangible assets that receive a deduction under the research and development provisions.

Cars and the investment allowance

A car will be eligible for the Investment Allowance if car expenses are claimed under:

- The one third of actual expenses method;
- The log book method; or
- The 12% of original cost method.

A car will not be eligible for the Investment Allowance if car expenses are claimed under the cents per kilometre method. The following table summarises how the Investment Allowance can apply to cars:

Car expenses claimed under following method...	Eligible for Investment Allowance?
One third of actual expenses	Yes, provided over 50% business use
Log book	Yes, provided over 50% business use
12% of original value	Yes, provided over 50% business use
Cents per kilometre	No

Please note the Investment Allowance will be capped against the luxury car limit i.e. \$57,180 for the 2008/2009 income year instead of the actual 'cost'.

Lease agreements

To be eligible to claim the Investment Allowance, the entity claiming the allowance must generally have legal ownership of the asset although in some cases the 'economic' owner will be the holder of the asset.

For lease arrangements, whether you 'hold' the asset will depend on the nature of the lease. If the arrangement is a hire purchase then the lessee will generally be the 'holder' of the asset. If the arrangement is a finance lease and it is likely the lessee will acquire the asset at the end of the lease, they may be the 'holder' of the asset. If the arrangement is a standard operating lease then they are unlikely to 'hold' the asset.

Example 2.1 – Leasehold improvements

Invest Co currently operates their business from the ground floor of a premises rented from a third party.

They undertake a \$90,000 leasehold improvement project (contract entered into in June 2009) made up of constructing new offices on their floor and installing new desks and partitions.

Invest Co will be able to claim the Investment Allowance on the expenditure that went towards purchasing and installing the new desks and partitions that are not completely affixed to the building. The expenditure on offices and other fittings etc that are affixed to the building will be classified as capital works and will therefore not be eligible for the Investment Allowance.

For a luxury car lease, the lessee is treated as the holder of the lease for the time the lessee has the right to use the car.

Novated Leases

Under a standard novated lease for a motor vehicle, the employer will meet the repayments under the leasing arrangement while the third party will retain ownership of the vehicle.

Under a standard novated lease, there will not be an expectation that the employer will acquire the vehicle at the end of the lease i.e. not expected to pay-out the residual. As there is no expectation that the employer will purchase the vehicle and the employee is not the economic or legal owner of the vehicle, the Tax Office's view is that neither the employer or the employee 'holds' the asset for the purpose of claiming depreciation deductions. This means that neither the employer nor the employee will be eligible for the Investment Allowance for a vehicle that is the subject of a standard novated lease.

The exception to this is where the vehicle is a luxury car i.e. if the vehicle has a cost exceeding \$58,170 for the year ending 30 June 2009, the employer is held to have 'acquired' the car for tax purposes.

Therefore, **a luxury car that is the subject of a novated lease can be eligible for the Investment Allowance** however, in most cases, a vehicle that is not a luxury car that is subject to a novated lease will not.

Partnerships

Where an asset is deemed to be 'held' by a partnership for the purposes of claiming depreciation deductions, the partnership is entitled to claim the Investment Allowance for the asset providing the other criteria have been met.

The asset can be 'held' by a partnership if it is either:

- Owned by the partnership; or
- Owned by one or more of the individual partners but is used in such a way (and is treated in such a way under the partnership agreement) that the asset is considered to be a partnership asset.

If the asset is not 'held' by the partnership and is owned (legally and economically) by the individual partner, the individual partner can claim the Investment Allowance in relation to the asset provided they satisfy the other requirements in relation to the Investment Allowance.

From a practical point of view, general partnership law considers that a partner in a partnership is carrying on their own 'business' provided the partnership is actually carrying on a business. Therefore, if a person is a partner in a general law partnership that is carrying on a business then they may be able to claim the Investment Allowance in relation to assets they use in the partnership business even though the asset is not a partnership asset.

Eligibility Criteria 3 – Asset must be 'new'

The Investment Allowance applies to the purchase of 'new' assets. An asset is 'new' if it has never been used or installed ready for use by anyone, anywhere. This means that **second-hand assets are NOT eligible for the Investment Allowance** (subject to the exception below). An asset will be second hand and ineligible if it has been used in a business, to derive income, or even if the asset was previously only used for private purposes.

An exception to the requirement that the asset is 'new' is for assets that are used for reasonable testing and trialling.

Example 3.1 – Demonstrator car

From page 14 of the Explanatory Memorandum

Belinda is contemplating the purchase of a demonstrator vehicle from a dealer for \$25,000 to use in her business.

Although the dealer had acquired the car new from the factory, he would regularly use the car to drive to and from work. The prior use by the car dealer does not constitute reasonable testing and trialling and Belinda would not be eligible to claim the Investment Allowance for the car.

If the demonstrator car in the example above was not used by the dealer, then the purchase of the car would be eligible for the Investment Allowance assuming all the other criteria have been met.

Eligibility criteria 4 – Assets cannot be eligible for special deduction concessions

If the asset is eligible for a deduction under Subdivision 40-F, 40-G or 40-J of the income Tax Assessment Act 1997 it will not be eligible for the Investment Allowance. These sections already provide deduction concessions.

These concessions apply to the following assets:

- Water facilities
- Horticultural plants
- Fences, levees, drainage works that qualify as ‘land care operations’
- Electricity and telephone lines (including metering points etc)
- Trees used in carbon sequestration activities

Eligibility Criteria 5 – The cost requirement

A small business entity can claim the Investment Allowance for eligible assets if the asset (or additional investment) ‘cost’ is at least \$1,000 GST exclusive (provided all the other conditions are met).

The Investment Allowance rules do allow certain expenditure to be ‘amalgamated’ for the purposes of determining whether the cost of the new asset or additional investment is at least \$1,000 GST exclusive.

For new asset purchases, **identical or substantially identical** assets can be added together for the purposes of satisfying the expenditure threshold. In addition, new assets that form **part of a set** can be added together for the purposes of satisfying the threshold.

Example 5.1 – Sold/marketed as part of a set

Edward (a small business entity) purchased a crockery set for use in the staff kitchen for \$1,100 GST exclusive.

The set contains items that can be purchased individually although the purchase by Edward was for the set of items packaged together.

This will be eligible for the Investment Allowance (provided the other conditions are met).

Example 5.2 – Different assets, similar use

Example from page 21 of the Explanatory Memorandum to the Bill

Edward buys a range of power tools for his business – a lawn mower, brush cutter and leaf blower.

While these assets add to Edward's stock of machinery, they are not a set. It would make no difference if Edward purchased them at the same time and from the same supplier or manufacturer.

Currently, there is an immediate write-off available for assets costing \$1,000 or less for small business entities. For the purposes of this \$1,000 write-off, you do not need to combine the costs of identical or substantially identical assets to determine eligibility. This anomaly gives rise the situation set out in Example 5.3 below.

Example 5.3 – Identical/substantially identical and SBE pooling

Invest Co (a small business entity) purchases 5 chairs for use in its business during June 2009. Each chair is identical and costs \$500.

For the purposes of the Investment Allowance, the cost of each chair can be amalgamated to determine whether Invest Co can access the Investment Allowance (they will be eligible as the combined cost is \$2,500). For the purposes of claiming an immediate write-off under the rules which apply to small business entities, Invest Co can claim an immediate 100% deduction for the cost of each chair in the year of purchase i.e. you do not need to aggregate the cost of identical/substantially identical assets to determine eligibility for the 100% deduction.

Therefore, in the year ending 30 June 2009, Invest Co can claim a 150% deduction (\$3,750) for the outlay of \$2,500.

If an amount has been incurred in one year but was not eligible for the Investment Allowance (e.g. total incurred under \$1,000 for a small business entity), the amount un-claimed **can be carried over** to the next year.

Eligibility Criteria 6 – The investment commitment requirement

Small business entities will be entitled to the 50% Investment Allowance as long as they enter a contract to buy the asset between 12.01am 13 December 2008 and 11.59pm 31 December 2009.

In terms of when the contract is entered into, this depends on whether you are acquiring a new asset or making an improvement to an existing asset.

For new assets, you will have committed to acquire the asset at the time you have:

- Entered into a contract under which you hold the asset or will start to hold the asset at some point in time;
- Started to construct the asset;
- Started to hold the asset in some other way.

This means that you do not need to have paid for the asset fully or taken delivery of the asset between 13 December 2008 and 31 December 2009. You simply must have entered into a contract, started construction and/or started to hold the asset (in some other way) between these dates.

Example 6.1 – Entering into a contract

John (a sole trader) verbally agrees to buy a car for use mainly in his plumbing business on 30 December 2009. He does not pay any deposit until 7 January 2010 and does not take delivery of the car until 1 February 2010.

Although technically John has entered into a contract for the acquisition of the car, we would strongly advise John to **GET SOMETHING IN WRITING** prior to 31 December 2009 that sets out details of the asset in question, terms, price etc. John may need to prove to the ATO that he entered the contract before 31 December 2009.

If you entered into a contract to purchase an asset prior to 13 December 2008, this requirement cannot be circumvented by ‘refreshing’ the contract (i.e. cancelling the original contract and establishing a new one).

For contracts entered into prior to 13 December 2008 that have an option to acquire the asset at a later time, the investment commitment is taken to have occurred when the option is exercised (not the date of the original contract). Therefore, provided the option is taken up prior to 31 December 2009 the Investment Allowance may apply.

The Investment Allowance can also apply where you construct your own assets for use in an Australian business. For the purposes of the Investment Allowance, the time at which you are held to have started to construct the asset is the time when you have demonstrated a clear intention or commitment to proceed with the construction. Where the decision making process that goes into the construction of the asset and the actual physical construction of the asset straddle the relevant dates for the Investment Allowance (i.e. 31 December 2009), determining when the construction actually ‘commenced’ could determine eligibility and the amount claimable.

Example 6.2 – Constructing own asset

Example from page 25 of the Explanatory Memorandum to the Bill

Greenfield Power is a power supply company that builds its own transmission lines. During mid-2008, the company started to contemplate building a number of new transmission lines. Over the remainder of 2008, preliminary design work was undertaken in anticipation of the project going ahead.

On January 15 2009, the company's directors sign off a decision to proceed with construction of the lines. However, the company does not physically start to construct the transmission lines or order materials at this stage.

On 10 February the relevant division of the company started to finalise the specification of the lines and placed the first of a series of orders for the necessary materials.

The investment commitment time for each of the transmission lines is 15 January 2009 as this is when the company evidenced a clear intention to proceed with the construction.

Eligibility criteria 7 – The first use/installed ready for use requirement

The year the Investment Allowance deduction is claimed is determined by the year the asset is first used or installed ready for use.

In order to claim the Investment Allowance in the 2008/09 income year, the contract for the acquisition of the asset (or the addition) must be in place by 30 June 2009 and the asset's first use time must be before 30 June 2009.

If the asset was not installed ready for use by 30 June 2009 but was installed ready for use by 30 June 2010 and the contract for the acquisition of the asset was entered into prior to 30 June 2009, you can claim the Investment Allowance deduction in the 2009/10 tax return.

The following table sets out the income years in which the Investment Allowance can be claimed **for a small business entity** (a business with an aggregated turnover below \$2 million).

Commitment to buy the asset made by....	
Installed ready for use by...	31 December 2009
30 June 2009	50% in 2008-09
30 June 2010	50% in 2009-10
31 December 2010	50% in 2010-11
