

Australia introduces instant asset write-off alternative \$5b turnover test and opt out rule

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Executive summary

On 2 December 2020, previously announced amendments were introduced into Parliament (in [Treasury Laws Amendment \(2020 Measures No. 6\)](#) Bill 2020) to:

- ▶ Provide an alternative turnover test (<\$5 billion¹ alternative test) for the temporary "full expensing of depreciating assets" instant asset write off (IAWO) 2020 Budget measure (Subdivision 40-BB²); and
- ▶ Allow taxpayers to opt out of this IAWO and the backing business investment incentive rules (Subdivision 40-BA²).

The Bill follows submissions by EY.

Detailed discussion

The <\$5b alternative test

The temporary full expensing IAWO measure applies to eligible assets first held, and first used or installed ready for use for a taxable purpose from 6 October 2020 until 30 June 2022. There is also an immediate deduction for the full cost of improvements to these assets and to existing eligible depreciating assets made during this period.

As originally enacted, these rules required a <\$5b “aggregated turnover” threshold to be met. Aggregated turnover (revenue) includes the worldwide income of the entity as well as its connected entities and affiliates – the inclusion of the income of connected entities and affiliates has excluded some taxpayers.

The Bill provides a welcome alternative <\$5b test to operate on a company-by-company turnover basis and does not include connected entities and affiliates.

The <\$5b alternative test is met if:

- ▶ The entity is a corporate tax entity at any time in the income year (as a result, most trusts and partnerships are excluded)
- ▶ The entity’s total ordinary and statutory income other than non-assessable non-exempt income is less than \$5b for either the 2018-19 or the 2019-20 income year
- ▶ The total cost of certain depreciating assets first held and used, or first installed ready for use, for a taxable purpose in the 2016-17, 2017-18 and 2018-19 income years (combined) exceeds \$100m

For a tax consolidated group, the above tests are applied to the tax consolidated group.

As an integrity measure, if an entity’s 2019-20 income year ends after 6 October 2020 under a substituted accounting period, the \$5b income test applies for the 2018-19 income year only.

The \$100m minimum total cost of depreciating assets test is a policy measure intended to ensure eligible entities have a track record of making substantial investments in Australia.

In calculating the \$100m total cost:

- ▶ Aggregate the cost of each depreciating asset (including the second element of the asset’s cost in that income year) for the income year in which it was held and first used, or first installed ready for use, for a taxable purpose.
- ▶ Exclude the following costs – the cost of any intangible assets or depreciating assets that, at the time they were first used or installed ready for use, were not expected to ever be located in Australia or not expected to be used principally in Australia for the principal purpose of carrying on a business.

The new <\$5b test is an alternative only, therefore entities which already qualify under the current aggregated turnover test do not need to meet the \$100m asset test.

Entities which utilize the alternative test are also unable to claim the IAWO for intangible assets (e.g., software), assets previously held by associates, or assets which are available for use in that income year either by associate entities or a foreign resident.

The Bill also introduces a deemed market value balancing adjustment event that occurs if a depreciating asset has its decline in value worked out under the temporary full expensing IAWO provisions and in a later income year the asset no longer meets the test regarding its use or its location in Australia.

Election to not apply IAWOs (temporary full expensing and the backing business investment incentive measures)

The Bill introduces an irrevocable election to allow entities to opt out of the temporary full expensing IAWO and the backing business investment incentives which provides taxpayers with a <\$500m aggregated turnover a 50% deduction in the first year. The opt out applies on an asset-by-asset basis. If the entity chooses to opt out it would then apply the general capital allowance rules for that asset.

However, the choice to opt out is **not** available to taxpayers with aggregated turnover under \$500m who must apply the enhanced IAWO applicable for eligible assets costing under \$150,000 acquired from 12 March 2020 to 31 December 2020 and installed prior to 30 June 2021.

The election not to apply the temporary full expensing IAWO provisions and the backing business investment incentive must be made for each particular depreciating asset. The election to opt out must be made in the approved form and given to the Commissioner of Taxation by the day the entity files its tax return for the income year to which the choice for an asset relates (or otherwise as the Commissioner of Taxation may allow).

Because the opt out is on an asset by asset basis, taxpayers will be able to closely manage their use of the full expensing IAWO and backing business investment entitlements.

Examples of situations where taxpayers may wish to elect to opt out include where:

- ▶ The deduction may impact a taxpayer’s ability to frank dividends
- ▶ The deduction may create or increase an income tax loss for a year that the taxpayer is concerned may not be able to be carried forward

- ▶ The deduction may impact entitlements to other tax credits such as foreign income tax credits
- ▶ Taxpayers wish to manage the impact on the tax cost setting of assets upon joining a tax consolidated group (discussed below)
- ▶ Taxpayers which for administrative or other reasons prefer a closer alignment to their accounting depreciation profile and/or economic use of impacted assets

Tax consolidation push down interaction

Notwithstanding EY submissions, it remains the case that if an entity joins a tax consolidated group in the future after having benefited from the enhanced IAWO, backing business investment incentive or full expensing IAWO, then affected assets will not have their tax cost reset above their existing written down value. The tax cost that would otherwise be allocated to the asset in excess of its existing tax base (which may be \$0 for IAWO assets and 50% or less of its cost for accelerated depreciation assets) is not re-allocated amongst the other assets of the joining entity. This aspect is expected to result in complexities in future mergers and acquisition transactions.

Loss carryback amendment

The Bill also makes an amendment to clarify and confirm that the choice under the temporary loss carryback measure must be to notionally carryback a specified fixed dollar amount of an entity's tax loss to an earlier income year and a percentage of a tax loss approach cannot be used.

Implications

Considering the significant deductions available, taxpayers should carefully review their eligibility for the concessions.

In light of the potential impact on future tax consolidation and current year tax outcomes, taxpayers will need to carefully consider making an irrevocable asset by asset opt out election. This may require both assessing whether the asset/expenditure is eligible and then whether to opt out for a particular asset.

Endnotes

1. Currency references in this Alert are to the AU\$.
2. *Income Tax (Transitional Provisions) Act 1997*.

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