

1 February 2021

Ms Maryanne Mrakovcic
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CC: The Hon Josh Frydenberg MP, Treasurer: josh.frydenberg.mp@aph.gov.au
The Hon Michael Sukkar MP, Assistant Treasurer: michael.sukkar.mp@aph.gov.au

Dear Ms Mrakovcic

Full expensing of depreciating assets and small business entity pooling

Chartered Accountants Australia and New Zealand, CPA Australia, Institute of Public Accountants, Law Council of Australia, Tax & Super Australia and The Tax Institute (together the **Joint Bodies**) write to you as the peak professional accounting and tax practitioner bodies in Australia representing the tax profession at the invitation of Treasury officers with whom we have been discussing these new provisions.

Summary

Our submission below addresses our main concerns, and that of our members, in relation to the recent legislative amendments contained in Schedule 1 to the [Treasury Laws Amendment \(2020 Measures No. 6\) Act 2020](#) (the amendments).

The amendments are intended to provide businesses with flexibility to choose whether to apply the new full expensing of depreciating assets (**FEDA**) measure on an asset-by-asset basis. However, this flexibility is not available to small business entities (**SBE**). By the operation of the law, SBEs are required to fully expense their general small business pool (**pool**) balances on 30 June 2021 and cannot choose not to write off the pool balance.

Analysis of provisions

New subsection 328-181(5) of the *Income Tax (Transitional Provisions) Act 1997 (IT(TP)A)* — inserted by the [Treasury Laws Amendment \(A Tax Plan for the COVID-19 Economic Recovery\) Act 2020](#) — requires SBEs to fully deduct the pool from 6 October 2020 to 30 June 2022 where the pool balance is more than zero. From 1 July 2022, the ordinary rule in section 328-210 of the *Income Tax Assessment Act 1997 (ITAA 1997)* reverts to require SBEs to deduct their pool balance where the amount (worked out under subsection 328-210(2)) is less than \$1,000.

If an SBE chooses to continue to apply Subdiv 328-D of the ITAA 1997, the entity must fully deduct the pool balance on 30 June 2021 (assuming it was not already fully deducted on 30 June 2020 because the balance, as worked out under subsection 328-210(2), was less than \$150,000).

There is a choice in Subdiv 328-D to choose not to apply the subdivision for an income year, but choosing to exit the subdivision does not change the outcome.

If an SBE chooses to exit Subdiv 328-D and instead apply Div 40 of the ITAA 1997 to their depreciating assets, section 328-220 of the ITAA 1997 applies to require the SBE to continue to apply Subdiv 328-D to the pool for the income year in which they exit Subdiv 328-D and all later income years. This means that section 328-210 of the ITAA 1997 will continue to apply, as temporarily modified, in its operation by subsection 328-181(5) of the IT(TP)A.

In comparison, non-SBE taxpayers have the choice as to whether they fully expense an asset under Subdiv 40-BB of the IT(TP)A or depreciate the asset under the ordinary provisions of Div 40. Non-SBE taxpayers can also allocate low-cost assets (those costing less than \$1,000) to a low-value pool which attracts an accelerated rate of depreciation.

Discussion

The practical effect of all these rules is that an SBE is required to fully deduct their pool balance on 30 June 2021, whereas larger businesses have the flexibility to choose not to apply full expensing on an asset-by-asset basis.

The amendments were designed to allow entities to choose whether to apply full expensing, so they can choose not to fully expense an asset. Nothing in the Explanatory Memorandum to the amending bill suggested the amendments would apply to 'eligible businesses' provided they are not SBEs with pool balances. However, practically, the amendments do not extend to SBEs which are still required to write off their pool balances on 30 June 2021. This could cause adverse tax outcomes for some SMEs.

This will be particularly problematic for discretionary and unit trusts that are commonly used in the SME sector. Full expensing may result in a loss being made by a trust, resulting in the trust having no distributable income. This will be most evident where the income of the trust estate in the deed is defined to be equal to the net income as defined in section 95 of the *Income Tax Assessment Act 1936* (**income equalisation clause**), and will result in the inability of the trustee to distribute any franking credits attached to dividends received by the trust to beneficiaries, or fully utilise the franking credits.

Example — 2020–21 income year

	SBE taxpayer	Non-SBE taxpayer
Assessable income (includes less than \$2 million of dividend income and franking credits)	\$5,000,000	\$12,000,000
Allowable deductions	(\$4,400,000)	(\$11,400,000)
Taxable income of trust before applying deduction for pool balance or full expensing	\$600,000	\$600,000
Deduction for pool balance of \$900,000 under subsection 328-181(5) of the IT(TP)A	(\$900,000)	Not subject to subsection 328-181(5) and chooses not to fully expense under Subdiv 40-BB an asset costing \$900,000 (instead claims depreciation of \$50,000)

	SBE taxpayer	Non-SBE taxpayer
Taxable income/(loss) of trust	(\$300,000)	\$550,000
Distributable income of trust (assume deed contains an income equalisation clause)	(\$300,000)	\$550,000
Outcome	Unable to fully utilise the franking credits — these are lost and unable to be passed on to beneficiaries	Able to fully utilise the franking credits by passing them on to beneficiaries

This issue concerns many of our members whose SBE clients will face adverse tax outcomes because of the mandatory fully expensing of pool balances, some of which are of significant values.

Backing Business Investment incentive

Schedule 1 to the [Treasury Laws Amendment \(2020 Measures No. 6\) Act 2020](#) also made equivalent amendments to Subdiv 40-BA to allow entities to opt out of the backing business investment (**BBI**) incentive on an asset-by-asset basis.

The BBI incentive gives businesses with an aggregated turnover of less than \$500 million an accelerated rate of depreciation of 50% in the first year where the depreciating asset is first held, and is first used or installed ready for use, for a taxable purpose between 12 March 2020 and 30 June 2021. SBEs can claim a deduction at the rate of 57.5% for depreciating assets allocated to a pool.

The accelerated depreciation available under the BBI incentive for SBEs will add to the loss problem discussed above for high value items acquired during the eligible period.

In addition to the FEDA opt-out, non-SBE taxpayers have also been provided with a BBI incentive opt-out by the insertion of section 40-137 at the end of Subdiv 40-BA of the *Income Tax (Transitional Provisions) Act 1997*.

Recommendation

The policy intent was clearly to give flexibility to all businesses. However, the translation of that policy into law seems not to have covered the field completely, by failing to address the SBE pooling issue.

The Joint Bodies seek that the law be amended to provide SBE taxpayers with the same flexibility as larger businesses, and to ensure that larger businesses are not treated more favourably than SBEs, or those that are still subject to the pooling rules in Subdiv 328-D after making a choice to exit Subdiv 328-D. Flexibility is sought for SBEs for both the FEDA measure and the BBI incentive.

There may be other ways of achieving this outcome besides providing SBEs with a choice not to use Subdiv 328-D. We would be pleased to be involved in further discussion and consultation on such alternative solutions.

We have considered whether there may be administrative options to address this issue and have concluded that the current laws do not permit this.

If you would like to discuss any of the above, please contact The Tax Institute's Tax Counsel, Julie Abdalla, on (02) 8223 0058 in the first instance.

Yours faithfully,



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