



## Tax Insights

# Full expensing of depreciating assets - Bill introduced for alternative eligibility test

### Snapshot

The 2020-21 Federal Budget handed down on 6 October 2020 included a **temporary full expensing (TFE) measure** for depreciating assets. The original Budget announcement has already become law under the *Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Act 2020*.

On 2 December 2020, the Government introduced [Treasury Laws Amendment \(2020 Measures No. 6\) Bill 2020](#) into the Parliament. The Bill includes amendments to the TFE measure (referred to as the **2 December 2020 amendments**), as announced by the Treasurer on 23 November 2020. Those amendments, amongst other changes, introduce an alternative turnover eligibility test and also allows entities to opt out of TFE on an asset-by-asset basis.

This publication has been **updated as of 2 December 2020**.

## Overview of changes to the TFE measure

The TFE measure as originally legislated requires an “aggregated turnover” of less than \$5 billion: this includes the relevant income of the entity, its connected entities and its affiliates. As a result, the existing test is effectively based on a worldwide income concept, and is not limited to income which has some form of connection to Australia. Further, the TFE measure as legislated requires that immediate expensing apply to all relevant assets (i.e., there is no choice to opt out).

On 23 November 2020, the Treasurer [announced](#) that the Government will introduce legislation to expand eligibility for the TFE measure, that will provide for an alternative eligibility test.

The 2 December 2020 amendments provide an alternative eligibility test to apply where:

- The entity’s total ordinary and statutory income, other than non-assessable non-exempt (NANE) income, is less than \$5 billion for either:
  - The 2018-19 income year; or
  - The 2019-20 income year, including entities with substituted accounting periods in lieu of 30 June 2020, but only where the 2019-20 income year ended on or before 6 October 2020; and
- The total cost of certain depreciating assets (other than intangible assets) first held and used, or first installed ready for use, for a taxable purpose in the 3 year period: the 2016-17, 2017-18 and 2018-19 income years (combined) exceeds \$100 million.

The 2 December 2020 amendments also permit businesses to opt out of the TFE on an asset-by-asset basis.

Further comments regarding the 2 December 2020 amendments are made below, principally under the headings:

- Election to opt out of TFE;
- Alternative test for TFE eligibility; and
- Other related amendments

It is expected that the 2 December 2020 amendments will be passed by the Parliament during the December 2020 sitting ending on 10 December 2020.

Set out below is a table showing the Budget costings associated with the TFE measure over the forward estimates period, as per the initial announcement as well as the Budget impact of the 2 December 2020 amendments.

As is evident, the Budget impact is not forecast to be significant. However, it should be noted that the effect of the 2 December 2020 amendments will both be to expand the eligibility to the TFE measure (which will increase the Budget impact) as well as to allow taxpayers to opt out of the TFE measure (which will decrease the Budget impact).

	2020-21 \$M	2021-22 \$M	2022-23 \$M	2023-24 \$M	Total \$M
<b>Original Budget announcement</b>	-1,500	-11,400	-18,100	4,300	<b>-26,700</b>
<b>2 December 2020 amendments</b>		-20	-30	10	<b>-40</b>
<b>Total</b>	<b>-1,500</b>	<b>-11,420</b>	<b>-18,130</b>	<b>4,310</b>	<b>-26,740</b>

## Relevance

The TFE of depreciating assets measure is relevant to you if:

- Your aggregated turnover is less than \$5 billion **OR** you satisfy the alternative eligibility test; and
- You will be acquiring new depreciating assets or making improvements to existing depreciating assets before 30 June 2022.

## Overview

Under the TFE measure, a taxpayer is entitled to an immediate deduction for the full cost of an eligible depreciating asset in a year (the **current year**) if the taxpayer:

- Starts to hold the asset after 7.30pm, ACT time on 6 October 2020 (**2020 budget time**);
- Starts to use the asset, or has it installed ready for use for a taxable purpose in the current year, and on or before 30 June 2022;
- Has aggregated turnover of less than \$5 billion for the current year **OR** satisfies the alternative eligibility test; and
- No balancing adjustment event happens to the asset in that year.

The measure is subject to an Australian-nexus test which can be broadly described as the asset is to be located in Australia and principally used in Australia for the principal purpose of carrying on a business.

Taxpayers can also immediately deduct the full cost of improvements made to these assets and to existing eligible depreciating assets made during the same period.

Where a taxpayer meets the above conditions but has aggregated turnover of more than \$50 million, additional conditions apply. Such taxpayers will not be eligible for the TFE where certain conditions are satisfied such as where the commitment to acquire the asset was made prior to the 2020 budget time or if the asset was a second-hand asset.

Where the expenditure is eligible for a TFE deduction, these provisions apply to the exclusion of other tax depreciation regimes. The 2 December 2020 amendments will now allow businesses to opt out of the TFE and also the Backing Business Investment (BBI) incentives on an asset-by-asset basis, thereby providing businesses with more flexibility in respect of these measures.

Separately, in respect of the enhanced Instant Asset Write-Off (IAWO) provisions, which is broadly applicable for assets up to a cost of \$150,000 for taxpayers with turnover up to \$500 million, the first use or installed ready for use date was extended under the *Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Act 2020* from 31 December 2020 to 30 June 2021.

## Pre-Budget investment incentives

The following measures were already in place prior to the 2020-21 Budget.

### Enhanced instant asset write-off (IAWO)

- Businesses with aggregated turnover below \$500 million can claim an **immediate deduction** by way of IAWO for the business portion of the cost of an asset from **12 March 2020 to 1 December 2020**. The 2020-21 Budget has extended the period first used or installed ready for use to **30 June 2021**;
- Applies to new and second-hand assets first used or installed ready for use in this timeframe;
- Threshold for each asset is \$150,000; and
- Eligible assets are assets for which a decline in value (i.e. tax depreciation) is deducted under section 40-25 of the *ITAA 1997*. An exclusion applies for assets that do not currently qualify for simplified depreciation rules. These include capital works deductions, software allocated to a software development pool, horticultural plants including grapevines, assets allocated to a low-value assets pool and assets that are leased out or expected to be leased out for more than 50% of the time on a depreciating asset lease.

### Backing Business Investment

- Businesses with aggregated annual turnover less than \$500 million can deduct 50% of the cost of an eligible asset at the time of installation, with existing depreciation rules applying to the balance of the asset's cost;
- Eligible assets refer to **new assets** that can be depreciated under Division 40 of the *Income Tax Assessment Act (ITAA) 1997* (i.e., plant, equipment and specified intangible assets, such as patents) acquired **between 12 March 2020 and first used or installed by 30 June 2021**;
- **Does not apply to second-hand Division 40 assets**, or buildings and other capital works depreciable under Division 43; and
- The 2 December 2020 amendments provide that taxpayers will have a choice on an asset by asset basis to avail themselves of this deduction.

## Legislative structure for TFE rules

The TFE provisions are to be found in Subdivision 40-BB of the *Income Tax (Transitional Provisions) Act 1997 (Transitional Provisions Act 1997)*. These provisions operate for the purposes of calculating the tax depreciation deduction<sup>1</sup>, and operate to the exclusion of other provisions in the *Transitional Provisions Act 1997* or the *ITAA 1997*.

An exception to this architecture is that for small business entities with an aggregated turnover of less than \$10 million, and which choose to apply the simplified depreciation rules, the TFE regime is contained in section 328-181 of the *Transitional Provisions Act 1997*.

## Eligible taxpayers

This measure applies where the taxpayer's relevant turnover is less than the \$5 billion aggregated turnover threshold or where the taxpayer satisfies the alternative eligibility test. The TFE is not limited to corporate tax entities: it is available to all taxpayers which meet the relevant conditions.

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<sup>1</sup> Which is referred to as a deduction for a "decline in value".

## The relevant period

The general position is that a taxpayer is covered by the TFE measure for a depreciating asset if:

- The taxpayer starts to hold<sup>2</sup> the asset at or after the 2020 budget time and on or before 30 June 2022; and
- The taxpayer starts to use the asset, or have it installed ready for use for a taxable purpose on or before 30 June 2022.

The TFE measure is not tied to particular years of income, although in practice for June year-end taxpayers, it will be available in respect of the 2020-21 and 2021-22 years. A taxpayer with a 31 December year-end could potentially claim the TFE deduction in respect of an asset first used in say, May 2022 which would be during the year ended 31 December 2022, most likely being an early balancer in respect of the 2022-23 year.

In respect of taxpayers with an aggregated turnover of **up to \$50 million**: provided that the above two conditions are satisfied on or before 30 June 2022, such a taxpayer can access the TFE measure even where a commitment to acquire the asset (for example, entry into a contract to acquire the asset) had been made **prior** to the 2020 budget time. Further, such a taxpayer is also eligible for immediate expensing in respect of second-hand assets. In respect of taxpayers with an aggregated turnover of **\$50 million or more**: the scope of the immediate expensing measure is narrowed. Such a taxpayer cannot claim a TFE deduction if one or other of the following pre-2020 budget time commitment events had occurred. The TFE deduction is not available if before the 2020 budget time the taxpayer:

- Entered into a contract under which it would hold the asset; or
- Started to construct the asset; or
- Started to hold the asset in some other way.

A taxpayer will not be taken to have entered into a contract merely because it acquired an option to enter into such a contract.

However, if a commitment has already been entered into in relation to a depreciating asset before the 2020 budget time, the TFE applies to allow a full deduction for the second element of cost for the asset that is incurred between the 2020 budget time and 30 June 2022.

There is a further anti-avoidance type exclusion where there is conduct prior to 6 October 2020 and post that date which seeks to defer the date that the taxpayer would otherwise be taken to have held the asset to a date after 6 October 2020.

Further, "second-hand assets" are also excluded for such taxpayers. If another entity held the relevant asset when the asset was first used or first installed ready for use, other than as trading stock or merely for the purposes of reasonable testing or trialing, the TFE deduction is not available. This exclusion is modified in respect of certain intangible assets.

In addition, if a depreciating asset is held by an entity that was **previously** a member of a consolidated group or a multiple entry consolidated group, the asset is a second-hand asset if the **entity** started to hold the asset at or after the 2020 budget time.

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<sup>2</sup> Section 40-40, ITAA 1997.

## Eligible assets

The TFE measure applies to assets which are depreciating assets<sup>3</sup>, subject to various carveouts. In order to be eligible, the asset must be used, or installed ready for use, for a taxable purpose. This initial testing does not contemplate apportionment of the deduction, in cases where the asset may be used for both a taxable purpose and a non-taxable purpose (although refer below).

The TFE measure does not apply to an asset if any of the following exclusions operate:

- Assets which are excluded from Division 40, *ITAA 97* by section 40-45. In particular, this means that capital works for which an amount can be deducted under Division 43 are excluded;
- An asset if at the time it is first used or installed ready for use for a taxable purpose, either of the following are satisfied:
  - It is **not reasonable to conclude** that the taxpayer will use the asset **principally in Australia** for the **principal purpose of carrying on a business**; or
  - It is **reasonable to conclude** that the asset will **never be located in Australia**;
- The asset is allocated to a low value pool (Subdivision 40-E);
- Expenditure on the asset is allocated to a software development pool (Subdivision 40-E);
- You or another taxpayer has deducted or can deduct amounts for the asset under Subdivision 40-F, dealing with primary production depreciating assets.

There is no dollar limit as to the assets that can qualify for the TFE deduction.

## Deduction

Where the TFE measure applies to an asset (a post-2020 Budget depreciating asset), the taxpayer is **entitled to a deduction** in the year in which the asset is first used or installed ready for use (the current year) for the **full amount of the asset's cost**<sup>4</sup> as at the end of the current year, excluding any amount included in the cost of the asset after 30 June 2022. This deduction should include the first element of the asset's cost and the second element of the asset's cost (amounts paid to bring the asset to its condition and location, including the cost of improvements).

In addition, a TFE deduction is available for the full amount of second element of cost of both post-2020 Budget depreciating assets and existing depreciating assets.

Where deductions in respect of a tax depreciating asset have been claimed under the enhanced IAWO or the BBI incentive, the TFE may still be available in respect of the second element of cost of the asset that is incurred from the 2020 budget time to 30 June 2022.

## Election to opt out of TFE

The 2 December 2020 amendments provide that taxpayers will have a choice on an asset by asset basis to avail themselves of the TFE deduction.

A taxpayer may choose that the TFE provisions do not apply in respect of a particular depreciating asset. The choice cannot be revoked, must be made in the approved form, and the taxpayer must give the choice to the Commissioner by the time of lodgement of the income tax return for the relevant income year.

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<sup>3</sup> Refer section 40-30, *ITAA 1997*.

<sup>4</sup> Refer Subdivision 40-C, *ITAA 97*.

The Explanatory Memorandum notes that the Commissioner may determine the manner in which the choice is required to be made and defer the time for lodgment. Further guidance is expected from the Commissioner in this regard.

If an entity opts out of TFE for a particular asset, the taxpayer applies the standard capital allowance rules instead.

### Existing turnover test

#### Less than \$5 billion turnover

Under existing legislation, the TFE deduction is only available to businesses with a turnover that is relevantly less than \$5 billion. As noted above, the taxpayer is entitled to an immediate expensing deduction in the year in which the asset is first used or installed ready for use (the current year). In respect of that current year, the taxpayer must be:

- A small business entity (under Subdivision 328-C) for the loss year (broadly, a turnover of less than \$10 million); or
- Would have been a small business entity for the loss year under Subdivision 328-C if certain modifications were made to under Subdivision 328-C. The modifications broadly adopt the existing framework of Subdivision 328-C but replace references to \$10 million with references to \$5 billion.

In broad terms, the question is essentially whether in the:

- Current year; **or**
- Year immediately preceding the current year,

the aggregated turnover of the taxpayer for **either** of those years was less than \$5 billion.

For example, where the deduction is to be claimed in the 2019-20 year, the question is whether the aggregated turnover for **either** the 2019-20 or the 2018-19 years was less than \$5 billion.

#### Aggregated turnover

Aggregated turnover is defined to mean the sum of the annual turnover for a particular year of:

- The taxpayer;
- An entity that is **connected** with the taxpayer at any time during the year; and
- An entity that is an **affiliate** of the taxpayer at any time during the year.

Care will need to be taken to identify all entities that are **connected with** or an **affiliate of** the taxpayer. Relevantly, annual turnover is defined as the total **ordinary income** that the entity derives in the relevant year in the **ordinary course of carrying on a business**.

As mentioned above, this test includes the relevant income of the taxpayer on a worldwide basis.

### Alternative test for TFE eligibility

The 2 December 2020 amendments provide an alternative eligibility test to apply where:

- The entity's total ordinary and statutory income, other than NANE income, is less than \$5 billion for either:
  - The 2018-19 income year; or
  - The 2019-20 income year, including entities with substituted accounting periods in lieu of 30 June 2020, but only where the 2019-20 income year ended on or before 6 October 2020; and
- The total cost of certain depreciating assets (other than intangible assets) first held and used, or first installed ready for use, for a taxable purpose in the 3 year period: the 2016-17, 2017-18 and 2018-19 income years (combined) exceeds \$100 million.

### Alternative turnover test

It is intended that under this alternative test, businesses with an aggregated turnover of more than \$5 billion due to the inclusion of income of (for example) an overseas parent or associate (i.e., connected entities and affiliates) which were ineligible under the original budget announcement, will now be able to qualify for the TFE measure, but only if the business meets the prior year capex investment requirements. A comparison of the proposed criteria under the existing turnover test and the 2 December 2020 amendments is shown below:

	<b>Original test: Subdivision 328-C of ITAA 1997</b>	<b>Alternative eligibility test: Based on 2 December 2020 amendments</b>
<b>Threshold</b>	Less than \$5 billion.	Less than \$5 billion.
<b>Relevant income</b>	Ordinary income.	Ordinary income and statutory income, but excluding non-assessable non-exempt (NANE) income.
<b>Ordinary course of carrying on a business</b>	Ordinary income derived in the ordinary course of carrying on a business.	No requirement that the income be derived in the ordinary course of carrying on a business.
<b>Connected entities and affiliates</b>	Includes relevant income of connected entities and affiliates.	No equivalent rule. Does not include income of connected entities or affiliates.
<b>Business carried on only for part of year</b>	Annual income to be adjusted to include "reasonable estimate" assuming the business was carried on for the whole of the year.	No equivalent rule.
<b>Relevant year</b>	Rolling: The test is applied to either or both of the <b>current year</b> (based on a likely test) or the <b>previous year</b> .	Static: Based on relevant income as defined for the 2018-19 or 2019-20 income years (but only where the 2019-20 income year ends before 6 October 2020).
<b>Prior year capex</b>	No equivalent rule.	More than \$100 million in tangible depreciating assets in the three years, 2016-17 to 2018-19 years inclusive.

### **Prior period acquisitions of depreciating assets**

In addition to falling under the newly defined turnover test, a taxpayer must also have relevantly acquired depreciating assets (other than intangible assets) at a cost that exceeds \$100 million in the 2016-17, 2017-18 and 2018-19 income years.

The policy driver behind this test is that 2 December 2020 amendments target those entities that “have a track record of making substantial investments in Australia.”

The test looks at aggregating prior year costs of acquiring depreciating assets (other than intangible assets). The test does not require that the relevant assets still be held by the taxpayer at any particular time. Accordingly, it would seem for example that if a particular taxpayer (say a tax consolidated group) meets the prior year \$100M cost threshold for depreciating assets in the 2016-17, 2017-18 and 2018-19 income years, the test will be satisfied even if the relevant assets are no longer owned by the consolidated group (for example, due to asset sales or the disposal of an entity holding the relevant assets).

### **Other related amendments**

The 2 December 2020 amendments also make a number of other adjustments to the TFE measure and the tax loss carryback measure:

- An amendment is made to clarify the intended operation of the TFE measure by ensuring a balancing adjustment event occurs if a depreciating asset has its decline in value worked out under the TFE measures, and in a later income year, the asset no longer meets the test regarding its use or location in Australia;
- In respect of the tax loss carry back measure, those provisions are amended to clarify and confirm that the choice made must be to carry back a specified fixed dollar amount of an entity’s tax loss, rather than a percentage of a tax loss.

### **Next steps and key issues**

Challenges in successfully implementing the TFE regime will arise both with respect to the ongoing acquisition of “business as usual assets” as well as with respect to “major project assets”.

As regards business as usual assets, the temporary tax laws will need to be incorporated into the existing fixed asset register or registers, so it is important to ensure that existing systems are modified to accommodate these changes.

In many cases, the purchase of business as usual assets involves a significant volume of assets being purchased on an ongoing basis which over the period to 30 June 2022 could result in a significant cost. Meanwhile, to ensure compliance with the TFE rules, assets will need to go through a series of eligibility and ineligibility testing to determine whether the asset is to be depreciated at 100% or at some other rate for tax purposes. Furthermore, this needs to be operative for all post-2020 Budget depreciating assets with effect from 6 October 2020. Existing systems would need to be modified to correctly calculate the TFE deduction. These systems would also need to be enabled to correctly identify or categorise the assets that businesses would like to exclude from the TFE and BBI measures.

With respect to major project assets, these cases will likely involve considerable complexity both in terms of **identifying the relevant asset or assets**, and understanding the relevant contractual arrangements. The preparation of position papers for material asset purchases may be useful, as there may be greater scrutiny on fixed asset claims in the next few years.

The TFE regime is premised upon applying to a **particular** depreciating asset, and then having done so, addressing key issues including:

- When was **the asset** first held?
- When was **the asset** first used?
- When was **the asset** first installed ready for use?
- Was there a pre-6 October 2020 commitment with respect to **the asset**?
- Does the taxpayer prefer that the TFE measure not apply to **the asset**, and if so, has that choice been properly made?

It can be envisaged that it will often not be straightforward to identify the relevant asset and (for example) the time of entry into “a contract under which [a taxpayer] would hold the [relevant] asset”.

The ATO issued draft TR 2017/D1 in 2017 dealing with “composite items”<sup>5</sup>, and whether such a composite item is a single depreciating asset, or whether the components are separate depreciating assets. At present, this draft ruling is still not finalised.

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<sup>5</sup> A composite item is defined in TR 2017/D1 as an item that is made up of a number of components that are capable of separate existence. Whether a particular composite item is itself a depreciating asset or whether one or more of its components are separate depreciating assets is a question of fact and degree to be determined in the circumstances of the particular case.

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