Full expensing of assets - what it means for business

One of the Government's flagship measures announced in this year's Federal Budget was the ability for businesses with annual turnover of up to $5 billion to deduct the full cost of assets they acquire in the year they are installed. Measured in terms of the number of entities, the vast majority of Australian businesses are eligible. But what are the details, and are there limitations?

First to the details.

Eligible businesses can deduct the full cost of an asset in the first year of installation from budget night (7:30pm AEDT, 6th October 2020) until 30th June 2022. Assets purchased before budget night will still be subject to the $150,000 limit, but businesses will now have until 30th June 2021 to install the asset. In addition, small businesses (those with annual turnover of less than $10 million) using the small business depreciation pool must deduct the full remaining value of the pool at the end of the income year while the full expensing measure is in place. This includes any pre-Budget purchases that have already been pooled.

The timing however does raise a question about assets acquired before budget night, but installed after. Ordinarily an asset must be 'installed and ready for use' to be eligible for the instant asset write-off, but if it was acquired prior to Budget night, the old limit would apply, even where it wasn't (or won't be) installed until after that time. For businesses purchasing large, expensive assets, getting the 'acquisition' date right could make a significant difference to cash flow.

The scope of the scheme is staggering though, in terms of assets that an eligible businesses can claim. There really is virtually no limit. As Treasurer Josh Frydenberg said on Budget night,

> *"A trucking company will be able to upgrade its fleet, a farmer will be able to purchase a new harvester and a food manufacturing business will be able to expand its production line."*

The Treasurer referred to it as a 'game changer'. Business analysts agreed. Headlines touted a cost to the Budget in the billions of dollars. There's a reason though why increasing the instant asset write-off limit is a favourite lever of the Federal Government, and has been for a number of years: over the longer term, it doesn't really cost the Government much at all.

The primary benefit to a business is that it gets to bring forward a depreciation deduction it would otherwise have been entitled to over a number of years. This immediate deduction makes for a great cash saving in the current year by reducing the amount of tax payable...*in the current year*. But more tax will be payable in future years because there will be no further depreciation deduction available. Over the life of the asset then, the additional tax in future years will be enough to offset in full the tax saved in the current year (subject to applicable tax rates at the time). There is a short-term cost to the Federal Budget, but likewise, this will be recouped over future years. In total, over the effective life of the initiative, it is essentially revenue neutral.

There are a few other matters to be aware of too.

1. Firstly, **a business must have money, or access to finance, to be able to purchase significant assets**. If it doesn't, the measure is of no use as a stimulus measure. Even where it can access the necessary funding, is it prudent to do so? Many businesses are in a holding pattern right now, exercising caution while they see how this whole situation pans out.

   This is of course exactly the kind of trepidation the Government is hoping to counter, by encouraging businesses to throw caution to the wind and go out and spend. And in many cases, it might be the right move. But those that are experiencing challenging conditions right now would do well to consider carefully whether splurging on asset investment is appropriate at this time. It may be that a business determines that the cash flow benefit of this new measure is too good to pass up, and providing that it can afford the investment, it may be a 'game-changing' business decision. But businesses should subject any purchasing decision to the same level of rigor as they would without this new measure - budgets, projections, return on investment analysis, and so on. The opportunity to fully expense the cost of an asset in the first year shouldn't be the primary driver, because - just to labour the point - this is not a grant or a tax cut. It's purely a timing benefit.

2. Another thing to consider is that **ordinarily, a business needs to have made a profit in order to receive the cash flow benefit**. When a business reduces the amount of tax it has to pay on profits (in this case by increasing deductions), that's a cash saving. But no tax is payable on zero income, or anything less than that, so prior to Budget night, there was no immediate benefit for a business increasing existing losses by purchasing assets. The instant asset write-off would increase the tax loss (which may be able to be carried forward to future years), while the resulting tax payable remained zero.

   Whether or not it was the sole motivator, it seems that the Government anticipated this issue by also re-introducing a form of the loss carry-back measure for companies. We'll cover the details of this in a later issue, but it effectively creates a tax refund for eligible businesses by allowing current year losses to be offset against prior year profits. This could then mean that a business that makes a big purchase on assets to take advantage of the full expensing measure, but makes a loss, could still receive a handy injection of cash.

   It's worth noting though that losses can only be carried back as far as the 2018-19 financial year, and so if the value of the loss exceeds profits made since that time, any additional losses will still need to be carried forward to future years profits, which for many may seem quite a way off right now. Further, in what is a bit of a head-scratcher, **the loss carry-back provisions are only accessible for companies**. With a significant proportion of Australian small-medium enterprises operating within something other than a corporate structure, this renders the benefit entirely inaccessible to many businesses that need it. It also may make the full expensing of large asset purchases less attractive for some non-corporate entities. There are calls from several industry groups right now to see the loss carry-back provisions extended to all businesses, even though this may result in additional complexity (for example, those operating through trusts).

3. It's also important to recognise that **the benefit of the deduction won't be immediate.** For many businesses the cash refund generated may be delayed until beyond 30th June 2021, when

the 2021 income tax return can be lodged. Varying PAYG tax instalments may provide the opportunity to unlock it sooner, but even that won't be available until at least past the end of the relevant quarter, and still requires some forecasting work to ensure the variation is relatively accurate.

4. The option of **fully expensing an asset acquisition doesn't apply to most building construction costs and fixtures**. This may have a significant impact, for example, on upgrades to commercial properties. In most cases these will still be considered 'capital works', and instead of being deductible in full in the year of payment, will continue to be depreciated over a 40 year period!

One final comment: many businesses operate in highly specialised industries where it's not possible to source the equipment they need in Australia. Even where it is, there is no requirement under the provisions to source assets from Australian businesses in order to be eligible for the deduction. This will mean in many cases that only half the economic benefit of this measure may be realised. The purchaser may gain a cash flow benefit from the deduction, but the stimulus benefit to the seller may flow overseas. It would be nice perhaps to see some additional incentive provided for business to 'buy Australian', where this is possible.

There's no question that where it otherwise makes prudent business sense to invest in new assets, this is a great initiative which brings forward the tax benefit of that purchase into a period when it's most needed. In the current climate, it's a more daunting task to consider cost-effectively acquiring new assets when the deduction for them may be spread over many years into an uncertain future. There's little here though for businesses that are already on their knees (or close to it), through no fault of their own, and the narrow applicability of the loss carry-back provisions may mean its potential as a relief measure for struggling businesses is more limited than it could be.

If you have any questions about these measures or anything that was announced in the Federal Budget, please [contact us]**.**

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