# Tax break traps

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Terry Hayes Thursday 17 September 2009

**The new temporary investment allowance for businesses - otherwise known as the Small Business and General Business Tax Break - has been a hit. It provides a one-off bonus 50% tax deduction to small businesses where they acquire an eligible asset between 13 December 2008 and 31 December 2009, and the asset is installed or ready for use by 31 December 2010. The relevant dates are as follows:**

| Small business entities | |
|---|---|
| *Asset installed by:* | *New investment by 31 Dec 2009* |
| 30 June 2009 | 50% can be claimed in 2008-09 tax return |
| 30 June 2010 | 50% can be claimed in 2009-10 tax return |
| 31 December 2010 | 50% can be claimed in 2010-11 tax return |

The Government policy context of the Tax Break is simple enough - to provide an incentive in the form of a temporary bonus tax deduction for investment in new tangible assets. So far, so good. But that intent has to be put into words in the law, and that is often where complication and confusion can arise. This Tax Break is no exception in that regard. Let me explain.

The tax deduction is limited to new tangible, depreciating assets for which a deduction is available under the tax law and new investments in existing assets. An asset is new if it has never been used or installed ready for use by anyone, anywhere. Second-hand assets are not eligible for the deduction, nor is computer software.

Eligible assets held under a lease may still qualify for the Tax Break. However, the bonus deduction can only be claimed by the entity in the leasing arrangement who would claim capital allowance deductions in relation to the asset under Subdiv 40-B of the tax law. SMEs need to be especially careful of lease arrangements as they may affect who can claim the deduction.

Generally, cars used in a business qualify as assets that can be eligible for the deduction. However, determining whether the business can claim the deduction depends on the method used by the business to work out deductions for car expenses. An SME that uses the "third of actual expenses" and "log book" methods for claiming car expenses may be eligible for the deduction.

While the general rule is that the Tax Break is only available for investment in new assets, there is an exception where the previous use of the asset "was merely for the purposes of reasonable testing and trialling" (these are the actual words used in the law, and they can create their own difficulties as illustrated below).

To come within the scope of the exception, and therefore provide a deduction, not only must the use satisfy the description of testing or trialling, but the nature and extent of that use must also be reasonable. Demonstrator vehicles can qualify as "new assets" provided they have only been used for "reasonable testing and trialling".

There has been some confusion concerning demonstrator vehicles and the "reasonable testing and trialling" exception. Whether the use of a demonstrator motor vehicle for the purposes of testing and trialling is "reasonable" is a question of fact and degree in each case.

The Tax Office recently gave its views on a situation where a vehicle was registered and used as a "demonstrator" by a car dealer for almost 12 months before it was sold. The sale price of $30,000 was a $10,000 discount on the new vehicle price. At the time of sale, the odometer reading was 10,500 kilometres and two years of the original three-year manufacturer's warranty remained.

The Tax Office considered that the use of the demonstrator vehicle did not qualify as being merely for the purposes of reasonable testing and trialling in terms of the provisions of the tax law.

An asset can still be considered new despite it having been used for testing and trialling, if the nature and extent of that use is consistent with the asset retaining the essential attributes of what would be regarded as a new asset. If the testing and trialling results in the asset losing the quality of what is essentially a new asset, then the Tax Office considers that the use would mean the asset is not eligible for the Tax Break.

In the case of a motor vehicle that is sold as a "demonstrator", the Tax Office considers that the duration of the period for which it has been used, and the extent of the use in the sense of total kilometres travelled, will be indicators of whether the vehicle can still be considered new. In the above case, according to the Tax Office, the use of the vehicle by the dealer supported the ATO's objective conclusion that the use did not amount to reasonable testing and trialling.

The Tax Office formed the view that, at the time of purchase, the vehicle could not be considered new. It did so on the basis of a number of factors, including:

- the period over which the vehicle was used for testing and trialling. When the vehicle was sold, it had been registered and used as a "demonstrator" for almost 12 months;
- the decline in the market value of the vehicle compared to the new price. The sale price of $30,000 represented a $10,000 discount on the new car price;
- the number of kilometres travelled. The vehicle had travelled 10,500 kilometres in the course of its use for testing and trialling; and
- the balance of the manufacturer's warranty remaining. One year of the warranty had expired at the time of the purchase, leaving a balance of only two years.

There is the distinct possibility that some SMEs, and others, might have rushed in to buy qualifying assets to get the deduction, but without fully understanding how the law operates. While the deduction may ultimately turn out to have been correctly claimed, the opposite is also possible. Either way, SMEs should take professional advice when considering buying assets to get the deduction.

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