

The new small business budget measures – the value's in the detail

The Federal Government has released a package intended to stimulate confidence in the small business sector in the hope that it will ignite an economy that has been slow to respond to monetary stimulus.

One of the key small business measures that has received a considerable amount of media is the proposal to allow small businesses to immediately deduct assets purchased costing less than \$20,000 per item (up from \$1,000), up to 30 June 2017.

As a result of these announcements many small businesses are reviewing their technology infrastructure seeking to benefit from the cash flow benefits of an immediate tax deduction and capitalise on the latest in technology advancements.

The technology sector over the last five to ten years has transformed their traditional products and services, propelled by the increase in internet connection speeds and the demand from customers for greater flexibility both in functionality and cost.

It is with this in mind that in this article we compare the new small business measures with the current tax treatment of technology products.

Summary of budget changes

To be eligible for the immediate tax deduction of \$20,000, you first need to be a 'small business'. This is defined as:

- ▶ An entity that carries on business and where;
 - ▶ The entity's aggregated turnover (for the business it carries on) for the previous year was less than \$2 million; and/or
 - ▶ The entity's aggregated turnover (for the business it carries on) for the current year is expected to be less than \$2 million

It is important to note that aggregate turnover includes the turnover of "connected entities".

Whether a company is carrying on a business is a matter of fact and circumstances. Persons seeking to take advantage of this concession should seek professional guidance to confirm they are in fact carrying on a business.

Qualifying assets for immediate deduction

For small businesses that satisfy the conditions above, an immediate tax deduction will be available for assets costing less than \$20,000 acquired and installed ready for use between Budget night (7.30pm AEST 12 May 2015) and 30 June 2017.

Accordingly, this immediate deduction is likely to have a large impact for suppliers of business assets in the sub-\$20,000 price range and this includes the technology sector.

On the following page is a table outlining the differing tax treatment of alternative types of software and hardware under the existing and proposed depreciation regimes.

The accelerated depreciation will not be available for all assets however and will not apply to building works, structural improvements, certain horticultural assets (eligible for other concessions) and, with particular relevance for the technology industry, software development costs where a previous choice has been made to use specific software pooling arrangements.

The \$20,000 limit applies to each separate asset

The \$20,000 limit applies to each separate depreciating asset and small businesses can apply this \$20,000 rule to as many individual assets as they wish.

As with the existing depreciation rules, it will be necessary to identify what constitutes a separate asset for the purposes of meeting the \$20,000 threshold.

The ATO has not provided specific guidance on what would constitute a separate depreciating asset. However we believe that factors such as the functional independence of an item, its physical location and whether an item can be acquired separately, indicate whether an item would be a functionally separate depreciable asset.

Determining the cost of an asset

The cost of a depreciating asset is comprised of two elements. The first element, broadly stated, is the amount paid for the asset. The second element is the cost incurred in bringing the asset to its present condition and location.

In determining whether the cost of an asset falls below the \$20,000 limit it is important to consider both the first and second element costs.

Of particular relevance to the technology sector are fees relating to installation, consultation and customisation. Fees of this nature, if they relate to bringing an asset to its present condition or location, may be viewed as a second element cost. If this is the case then these additional costs must be factored into the cost of the asset when considering the application of the \$20,000 limit.

Having said this, if the first element of the cost is incurred in Year 1 (and the asset has either started to be used or is installed and ready for use) and the second element costs are incurred in a subsequent year, the \$20,000 limit will apply separately to the

first and the second element costs. Importantly however, for this treatment to apply:

- ▶ The first element costs must be written off in Year 1 (i.e. as an asset with a cost less than \$20,000); and
- ▶ The second element costs incurred in Year 2 must be the first such amount deducted in respect of the asset.

Assets costing \$20,000 or greater

For assets costing \$20,000 or greater that do not qualify for immediate deduction, the entity can continue to place the asset in a small business depreciation pool and have it depreciated at concessional rates. The pool (including existing pools) can be immediately deducted if the balance is less than \$20,000 over the period 7.30pm AEST 12 May 2015 to 30 June 2017.

For example, if a small business entity elects 'pooling' and acquires a depreciating asset for \$22,000 in the year ending 30 June 2015, whilst it may not qualify for the entire amount to be deducted immediately, it can deduct \$3,300 in the year ending 30 June 2015 under the pooling method and the remaining balance of \$18,700 can be deducted in the year ending 30 June 2016 provided that it does not have any other assets in the pool.

Suspension of 'lock out' from the simplified depreciation rules

The new law will also suspend the current 'lock out' laws for the simplified depreciation rules (application of the simplified depreciation rules are required to give effect to the above tax concessions).

Broadly, the lock-out rules prevent small businesses from re-entering the simplified depreciation regime for five years if they opt out. The suspension of the lock out laws will also apply up until 30 June 2017.

Conclusion

For those small businesses seeking to update their technology infrastructure, this package provides a cost effective opportunity to make that investment. Importantly, for those small businesses moving away from traditional technology platforms and embracing the move to software and infrastructure as a service, the tax effectiveness is longer term and is not limited to the recent package due to end in June 2017. This is highlighted in the table on the following page.

	New law	Current law
Operating systems*		
Perpetual licence	<ul style="list-style-type: none"> ▶ Immediately deductible under \$20,000 ▶ Depreciable over \$20,000 	<ul style="list-style-type: none"> ▶ Immediately deductible under \$1,000 ▶ Depreciable over \$1,000
Subscription licence	<ul style="list-style-type: none"> ▶ Deductible over the term of the license agreement 	<ul style="list-style-type: none"> ▶ Deductible over the term of the license agreement
Cloud subscription	<ul style="list-style-type: none"> ▶ Cloud Subscription ▶ Deductible over the term of the license agreement 	<ul style="list-style-type: none"> ▶ Cloud Subscription ▶ Deductible over the term of the license agreement
Cloud based services		
Software as a service (SaaS)	<ul style="list-style-type: none"> ▶ Deductible over the term of the agreement 	<ul style="list-style-type: none"> ▶ Deductible over the term of the agreement
Infrastructure as a service (IaaS)	<ul style="list-style-type: none"> ▶ Deductible over the term of the agreement 	<ul style="list-style-type: none"> ▶ Deductible over the term of the agreement
Platform as a service (PaaS)	<ul style="list-style-type: none"> ▶ Deductible over the term of the agreement. 	<ul style="list-style-type: none"> ▶ Deductible over the term of the agreement
Application software		
Perpetual licence	<ul style="list-style-type: none"> ▶ Immediately deductible under \$20,000 ▶ Depreciable over \$20,000 	<ul style="list-style-type: none"> ▶ Immediately deductible under \$1,000 ▶ Depreciable over \$1,000
Subscription licence	<ul style="list-style-type: none"> ▶ Deductible over the term of the license agreement 	<ul style="list-style-type: none"> ▶ Deductible over the term of the license agreement
Cloud subscription	<ul style="list-style-type: none"> ▶ Deductible over the term of the license agreement 	<ul style="list-style-type: none"> ▶ Deductible over the term of the license agreement
Hardware		
Servers	<ul style="list-style-type: none"> ▶ Immediately deductible under \$20,000 ▶ Depreciable over \$20,000 	<ul style="list-style-type: none"> ▶ Immediately deductible under \$1,000 ▶ Depreciable over \$1,000
Laptops/desktops	<ul style="list-style-type: none"> ▶ Immediately deductible under \$20,000 ▶ Depreciable over \$20,000 	<ul style="list-style-type: none"> ▶ Immediately deductible under \$1,000 ▶ Depreciable over \$1,000
Tablets/mobile devices	<ul style="list-style-type: none"> ▶ Immediately deductible under \$20,000 ▶ Depreciable over \$20,000 	<ul style="list-style-type: none"> ▶ Immediately deductible under \$1,000 ▶ Depreciable over \$1,000
Gaming systems	<ul style="list-style-type: none"> ▶ Immediately deductible under \$20,000 ▶ Depreciable over \$20,000 	<ul style="list-style-type: none"> ▶ Immediately deductible under \$1,000 ▶ Depreciable over \$1,000
Computer peripherals	<ul style="list-style-type: none"> ▶ Immediately deductible under \$20,000 ▶ Depreciable over \$20,000 	<ul style="list-style-type: none"> ▶ Immediately deductible under \$1,000 ▶ Depreciable over \$1,000

Consulting fees

If the consulting fees are provided in relation to bringing an asset to its present condition and location, then these fees would form part of the second element of the cost of an asset. If the total cost of the asset (including the associated consulting fees) is less than \$20,000 then an immediate deduction is available and depreciable over \$20,000.

In a situation where a consulting fee is incurred that does not specifically relate to bringing an asset to its present condition and location then such fees may be immediately deductible.

Careful consideration of the nature and type of any consulting fees should be given, including what, if any, asset the fee is attributable to and the timing of when the fees are incurred.

** Operating systems are rarely considered to be functionally separate to the hardware on which it is installed.*

Accordingly the operating system is "bundled" with the cost of the hardware and treated as a single asset.

In certain circumstances there may be a complete change in the operating system without a change to the underlying hardware. In this case the operating system would be considered a second element cost.

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