

Proposal: Extending the immediate deductibility threshold for small businesses

Assessment of the regulatory impacts

1. What is the problem you are trying to solve?

There are over 3 million small businesses in Australia. These small businesses contribute in many ways to the Australian economy – the small business sector contributes to national growth and competitiveness. Small businesses are also adaptable and flexible and they can respond quickly to changing circumstances. According to the Australian Bureau of Statistics, small businesses added around \$380 billion to the Australian economy in 2014-15.

Small businesses, however, face a unique set of operational challenges in the economy. This can be illustrated by the typically higher failure rates for small businesses compared with larger companies. Small businesses tend to be more vulnerable to cash flow problems than their larger counterparts because their profitability tends to be more volatile and they have lower levels of retained earnings. It is also not unusual for small businesses to have to manage a disproportionately higher compliance burden, per unit of turnover, than larger businesses.

Small businesses currently have access to a range of tax concessions – in particular, small businesses are able to fully and immediately deduct each eligible depreciating business asset they purchase costing less than \$20,000 (“the immediate deductibility threshold”). The \$20,000 threshold was the result of the 2015-16 Budget. It has been in place since 12 May 2015 and expires on 30 June 2017. This encourages small businesses to invest in new assets and replace old and out-dated equipment.

The ability to immediately deduct assets below \$20,000 is available to small businesses with turnover less than \$2 million. Businesses with turnover between \$2 million and \$10 million gain access to the concession from 1 July 2016 under the Enterprise Tax Plan legislation. Around 90,000 additional businesses gain access to the concession.

The immediate deductibility threshold of \$20,000 for small businesses will expire and revert back to \$1,000 on 1 July 2017, unless there is government intervention.

2. Why is government action needed?

There is a clear role for government to create the right policy settings for Australian small businesses. The Government’s objective with this proposal is to continue to stimulate small business investment and growth by providing cash flow benefits and reducing red tape for small businesses.

Australian small businesses are the engine room of our economy, making up 99 per cent of all businesses and contributing \$380 billion to the economy. A strong small business sector means more jobs for Australians and more opportunities to build vibrant local communities across the country.

3. What policy options are you considering?

Option 1: No policy change (revert to \$1,000 immediate deductibility threshold from 1 July 2017)

Under this option, there would be no new action taken by the Government and current rules regarding the immediate deductibility threshold (for assets costing less than \$20,000) would cease on 30 June 2017. Small businesses would go back to only being able to claim an immediate tax deduction for asset purchases that cost less than \$1,000 from 1 July 2017.

Option 2: Extending the immediate deductibility threshold until 30 June 2018 at the current \$20,000 threshold (preferred option)

This option would extend the \$20,000 immediate deductibility threshold for small businesses for an extra 12 months until 30 June 2018.

Small businesses would be able to immediately deduct purchases of eligible assets costing less than \$20,000 first used or installed ready for use by 30 June 2018. Assets valued at \$20,000 or more (which cannot be immediately deducted) would continue to be placed into the small business simplified depreciation pool and depreciated at 15 per cent in the first income year and 30 per cent each income year thereafter. The pool could also be immediately deducted if the balance is less than \$20,000 over this period (including existing pools).

Option 3: Extending the immediate deductibility threshold until 30 June 2018 but decreasing it from \$20,000 to \$15,000

This option would extend the immediate deductibility measure for a further 12 months but decrease the threshold so that it applies to eligible assets each costing less than \$15,000 (not \$20,000). Eligible assets valued at \$15,000 or more (which could not be immediately deducted) could be placed into the small business simplified depreciation pool and depreciated at the same rates as outlined above under Option 2. The pool could also be immediately deducted if the balance is less than \$15,000 over this period (including existing pools).

4. What is the likely net benefit of each option?

Option 1: No policy change (revert to \$1,000 immediate deductibility threshold from 1 July 2017)

Under this option, the current immediate deductibility threshold will expire and revert back to \$1,000 from 1 July 2017.

Benefits

The benefit of this option is that there would not be a revenue impact over the forward estimates.

Costs

The cost of this option, however, is that it would not stimulate small business investment and growth, given that there would be no additional cash flow benefits, and it would not reduce red tape for small business.

Option 1 - Net outcome

While there would not be a cost to revenue over the forward estimates, small business would not be able to access the additional cash flow benefits and red tape savings.

Option 2: Extending the current immediate deductibility threshold until 30 June 2018 at the current \$20,000 threshold (preferred option)

Under this option, the \$20,000 immediate deductibility threshold for small businesses would be extended for an extra 12 months until 30 June 2018.

Benefits

Currently, small businesses are able to immediately deduct the cost of asset purchases that are valued at less than \$20,000. Under the Enterprise Tax Plan legislation, around 90,000 additional businesses gain access to the concession.

Extending the immediate deductibility threshold until 30 June 2018 promotes small business investment and growth by providing additional cash flow benefits and reducing red tape for small business.

Small businesses tend to be more vulnerable to cash flow problems than larger businesses because their profitability tends to be more volatile and they have lower levels of retained earnings. The cash flow impact is also generally greater for new small businesses, as large capital expenditures often occur early in the life cycle of a business.

Immediate deductibility generally improves cash flow for small businesses by allowing an immediate deduction for the entire cost of an asset costing less than \$20,000 in the year that cost is incurred, rather than deducting a proportion of the cost over a number of years under the ordinary depreciation rules. In most instances, this reduces the tax bill of small businesses in the current income year, improving cash flow and therefore allowing them to use the extra funds to reinvest in their business.

There will also continue to be a compliance cost saving for small businesses through not needing to maintain a depreciation schedule for assets costing less than \$20,000. There will also be less complexity in filling out tax return forms for small business entities as depreciation amounts for assets below \$20,000 will no longer need to be calculated. There will also be less complex record-keeping for assets costing \$20,000 or more placed in the pool. This will result in an estimated total average annual regulatory saving for businesses of \$2.4 million (see Table 1).

Costs

This option will not increase compliance costs. In fact, compared to the status quo, there will be a decrease in overall compliance costs because it is an existing measure and there are no new requirements associated with the extension for 12 months.

Even for the approximately 90,000 additional businesses that gain access to the concession under the Enterprise Tax Plan legislation, it is expected that these companies would have already incurred their implementation compliance costs when planning their taxation affairs for the 2016-17 financial year. These costs were taken into account in the context of the Regulation Impact Statement for the Treasury Laws Amendment (Enterprise Tax Plan) Bill 2016.

This can be balanced with the financial cost. Extending the measure for an additional 12 months is estimated to have a net cost to revenue of \$650 million over the forward estimates.

Option 2 - Net benefit

The net result is that the significant benefits of improved cash flow for small businesses and reduced red tape outweigh the revenue costs associated with this option.

Table 1: Regulatory burden estimate (RBE) table (Option 2)

Average annual regulatory costs (from business as usual)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in cost
Total, by sector	-2.4*	n/a	n/a	-2.4

*Average annual impact (calculated over 10 years).

Option 3: Extending the immediate deductibility threshold until 30 June 2018 but decreasing it from \$20,000 to \$15,000

This option would extend the immediate deductibility threshold from 1 July 2017 until 30 June 2018 but decrease the threshold to \$15,000.

Benefits

This option would provide small businesses with similar cash flow benefits as Option 2 but only in relation to assets costing less than \$15,000.

This option would also reduce compliance costs for small businesses but to a lesser extent than Option 2 (see discussion below).

Costs

This option would result in a small decrease in compliance costs, resulting in an estimated total average annual regulatory saving for businesses of \$0.2 million (see Table 2). Small businesses would need to understand and adjust to the change in the new \$15,000 immediate deductibility threshold which adds to the compliance burden of this option.

Small businesses would not be able to access the benefits of immediate deductibility for assets costing between \$15,000 and \$20,000.

It would have a lower estimated cost to revenue than a \$20,000 immediate deductibility threshold over the forward estimates period.

Option 3 - Net benefit

The net result is that the benefits of improved cash flow and reduced red tape for small business outweigh the costs associated with this option but to a lesser extent than in Option 2.

Table 2: Regulatory burden estimate (RBE) table (Option 3)

Average annual regulatory costs (from business as usual)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in cost
Total, by sector	-0.2*	n/a	n/a	-0.2

*Average annual impact (calculated over 10 years).

5. Who will you consult about these options and how will you consult them?

The current \$20,000 immediate deductibility threshold was introduced in the 2015-16 Budget following extensive stakeholder consultation including with the Board of Taxation, the Australian Taxation Office (ATO), small business stakeholder groups and professional tax and accounting bodies.

Stakeholders have provided regular feedback on the effectiveness of the measure. There is strong stakeholder support for extending the immediate deductibility threshold.

6. What is the best option from those you have considered?

Taking into account the various benefits associated with this proposal, the preferred policy option is to extend the existing \$20,000 immediate deductibility threshold for small business for an additional year until 30 June 2018 (Option 2).

7. How will you implement and evaluate your chosen option?

Legislation is required to implement this proposal. Implementation is expected to be straightforward, as it is a continuation of an existing measure.

The ATO has responsibility for administering the legislation. Treasury and the ATO will continue to work together to implement the preferred option.

Evaluation of this proposal is ongoing. Feedback from stakeholders will continue to be assessed on a regular basis.