

Regulation impact statement:  
Backing small business investment –  
further extending the immediate  
deductibility threshold

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## 1. The problem

There are over 3 million small businesses in Australia. These small businesses contribute in many ways to the Australian economy, including 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 2015-16.

Small businesses currently have access to a range of tax concessions – in particular, they are able to fully and immediately deduct each eligible depreciating business asset they purchase costing less than \$20,000 (“the immediate deductibility threshold”).

Small businesses face a unique set of operational challenges, and as a consequence typically have higher failure rates than those for larger companies. A key reason for these higher rates of failure is the challenge small businesses face in managing their cash flow. This is exacerbated by the proportionately higher regulatory costs that small businesses bear relative to larger companies, largely due to their inability to take advantage of economies of scale in understanding and complying with regulation.

These reasons remain relevant to the operating environment for small businesses today. 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.

The \$20,000 threshold has been in place since 12 May 2015 and expires on 30 June 2018. Small businesses with an aggregated annual turnover of less than \$10 million (\$2 million before 1 July 2016) are able to access the concessional depreciation arrangements for eligible assets.

As noted in the 2015 regulation impact statement prepared for that measure, the threshold was increased to assist small businesses during a period of economic transition and to help counter the risk that the period of economic adjustment would be a protracted one and would result in a reluctance for businesses to invest and take on new workers absent stronger, sustainable demand.<sup>1</sup> During 2015, small businesses were responding by scaling back the level of their capital spending,<sup>2</sup> and had revised downwards their longer-term capital expenditure plans in the non-mining sector, notwithstanding solid growth that year.

In addition to helping counteract these behaviours during periods of economic downturn or structural adjustment, accelerated depreciation measures such as the immediate deductibility measure provide enhanced cash flow for small businesses. This can help businesses overcome cash flow pressures arising from other parts of their operations (for example, payment times).<sup>3</sup>

Immediate deductibility is beneficial irrespective of economic conditions given the associated cash flow benefits to business.

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<sup>1</sup> 2014-15 *Budget Paper 1* pages 2–11.

<sup>2</sup> *The Economic Trends, Challenges and Behaviour of Small Businesses in Australia*, Reserve Bank of Australia, 2014.

<sup>3</sup> *Payment Times and Practices Inquiry – Final Report*, Australian Small Business and Family Enterprise Ombudsman, 2017.

The immediate deductibility threshold will revert back to \$1,000 on 1 July 2018, unless there is government intervention. Under a \$1,000 threshold, while small businesses with annual turnover less than \$10 million could still take advantage of simplified depreciation rules, the cash flow benefits would be reduced and the red-tape costs greater. Small businesses that use these rules are required to track assets they depreciate to ensure all relevant adjustments are made to the small business pool and the appropriate tax deductions are claimed in their tax returns. Records are required to be kept to substantiate these claims. Further background on these costs is provided in the cost benefit analysis section below.

It is the extra cash flow upfront and less red-tape that the \$20,000 threshold provides that makes the difference for small businesses, especially new businesses with start-up costs. Small businesses can use this extra cash flow to re-invest in their business, such as buying new assets, paying down existing debt, and it may also give them the flexibility to hire more staff.

## 2. Case for government action/objective of reform

There is a clear role for government to create the right policy settings for Australian small businesses. The Government's objective 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 contributed around \$380 billion in 2015-16 to the economy. A strong small business sector means more jobs for Australians and more opportunities to build vibrant local communities across the country.

The immediate deductibility threshold is normally \$1,000 and since 12 May 2015 has temporarily been lifted to \$20,000. The Government has also expanded access to the write-off to small businesses with an aggregated annual turnover of less than \$10 million from 1 July 2016 (previously \$2 million). While the higher threshold has been welcomed by small business, which are keen to see it continued for at least one more year (or potentially permanently), any extension needs to be considered alongside the Government's broader strategic and fiscal priorities.

A temporary, rather than permanent, \$20,000 threshold induces a behavioural response, which encourages some small businesses to bring forward capital investment before the threshold reverts to \$1,000. If the higher threshold was made permanent, this behavioural response would be lost.

## 3. Policy options

### **Option 1: No policy change (revert to \$1,000 immediate deductibility threshold from 1 July 2018)**

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 2018. 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 2018.

### **Option 2: Extending the immediate deductibility threshold until 30 June 2019 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 2019.

Small businesses would be able to immediately deduct purchases of eligible assets costing less than \$20,000 which are first used or installed ready for use by 30 June 2019. 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 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 2019 but decreasing it from \$20,000 to \$10,000**

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 \$10,000 (not \$20,000).

Eligible assets valued at \$10,000 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 be immediately deducted if the balance is less than \$10,000 over this period (including existing pools).

## **4. Cost benefit analysis of each option/impact analysis**

**Option 1: No policy change (revert to \$1,000 immediate deductibility threshold from 1 July 2018)**

Under this option, the current immediate deductibility threshold will expire and revert back to \$1,000 from 1 July 2018.

***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 additional small business investment and growth, given that there would be no additional cash flow benefits and would not reduce red tape for small business.

Small businesses that use the simplified depreciation rules are required to track assets they depreciate under these provisions to ensure all relevant adjustments are made to the small business pool and the appropriate tax deductions are claimed in their tax returns. Records are required to be kept to substantiate these claims. Under the small business simplified depreciation rules, when assets are added to the small business pool, the small business can claim a deduction for 15 per cent of the asset's cost. The asset is then depreciated at 30 per cent per annum in the pool, until the pool balance falls below \$1,000. At this time, the remaining balance of the pool can be written off.

Small businesses are generally required to track the cost of the asset, the date it was acquired, the date and cost of the asset at the time it is added to the pool, as well as the details and timing of any subsequent improvements made to the asset. Small businesses also need to be mindful of the proceeds and timing of the sale of the asset, as these can result in additional tax liabilities or deductions.

***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 2019 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 2019.

### ***Benefits***

Extending the immediate deductibility threshold until 30 June 2019 promotes small business investment and growth by providing additional cash flow benefits and reducing red tape for small business. It also provides increased certainty as the threshold remains the same for another year.

Currently, small businesses are able to immediately deduct the cost of asset purchases that are valued at less than \$20,000.

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. A \$20,000 threshold also has a greater cash flow impact for new small businesses, as large capital expenditures often occur early in the lifecycle 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 allowing them to use the extra funds to reinvest in their business.

It also results in a compliance saving for small business as they are no longer required to track the annual depreciation for these assets or maintain detailed records substantiating their depreciation claims. Generally, a business would retain the invoice for purchase of the asset and use this as evidence to claim the cost of the asset (the immediate deduction) in their tax return.

By way of comparison, record keeping if the asset is depreciated under Division 40 of the *Income Tax Assessment Act 1997* (the general depreciation rules) or using the simplified small business pools is more onerous, and requires depreciation schedules (as well as other information mentioned previously) to be maintained in order to substantiate the depreciation deductions claimed in the tax return.

Over 300,000 Australian small businesses have taken advantage of the \$20,000 instant asset write-off according to 2015-16 tax data. Compared to 2014-15, in 2015-16 the number of claims increased by around 60,000 and the average amount claimed increased by \$4,100 to \$9,000.<sup>4</sup>

That small businesses are benefiting from the \$20,000 instant asset write-off has also been noted previously. On 13 October 2017, the then Minister for Small Business, the Hon Michael McCormack MP, noted that the policy has led to *'more money in the pockets of small businesses so they can grow their businesses, employ workers and pay them more.'*<sup>5</sup>

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<sup>4</sup> ATO income tax return data for the 2015-16 income year.

<sup>5</sup> The Hon Michael McCormack MP, then Minister for Small Business, '300,000 small businesses benefit from instant asset write-off', Media Release, 13 October 2017.

There is also anecdotal evidence of the benefits that the \$20,000 instant asset write-off provides from key stakeholders in the small business community:

- The Council of Small Business Australia (COSBOA), the national peak body representing the views of Australian small business associations, has congratulated the Government *'for maintaining their \$20,000 instant asset write-off for small businesses. This successful policy should be continued in the 2018-19 Budget. This is an important policy to all small businesses and we believe it must continue going forward.'* (2018-19 Budget Priorities Statement).

Industry-specific organisations have also noted the success of the \$20,000 instant asset write-off. This suggests that it has had a positive impact in terms of promoting additional investment, especially in capital intensive sectors such as building and construction. For example:

- Master Builders Australia, the nation's peak building and construction industry association *'recommends accelerated depreciation programs be extended for at least one more year. As a highly capital intensive industry made up of more than 350,000 small and medium sized businesses, the extension of the accelerated depreciation program was a big win for building and construction businesses from the previous Budget (2017).'* (2018-19 Pre-Budget Submission).
- Restaurant & Catering Australia (R&CA), the national industry association representing the interests of around 35,000 restaurants, cafes and catering businesses across Australia has noted the following: *'Given the strong take-up from businesses, R&CA urges the Commonwealth Government to continue its funding for this program, extending the instant asset write-off program until at least 30 June 2019.'* (Pre-Budget Submission 2018-19).

### **Costs**

This option will not increase compliance costs. In fact, compared with 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.

There is however a financial cost. Extending the measure for an additional 12 months is estimated to have a net cost to revenue of \$350 million over the forward estimates.

Relative to Option 1, this option may involve a negligible change in administration costs as the Australian Taxation Office (ATO) would need to amend its information resources, such as its website, to communicate that the \$20,000 threshold has been extended for a further 12 months.

### **Option 2 - Net benefit**

The net result is that the significant benefits of improved cash flow (encouraging small businesses to reinvest in and grow their business) and reduced red tape outweigh the revenue costs associated with this option.

This option will result in an estimated total average annual regulatory saving for businesses of \$2.2 million:

**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	-2.2*	n/a	n/a	-2.2

\*Average annual impact (calculated over 10 years).

**Option 3: Extending the immediate deductibility threshold until 30 June 2019 but decreasing it from \$20,000 to \$10,000**

This option would extend the immediate deductibility threshold until 30 June 2019 but decrease the threshold to \$10,000.

***Benefits***

This option would provide small businesses with cash flow benefits as in Option 2 but only in relation to assets costing less than \$10,000, which is half the current threshold.

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 \$10,000 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 \$10,000 and \$20,000.

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

Relative to Option 2, this option may also involve a small increase in administration costs as the ATO would need to amend its information resources, such as its website, to communicate to small businesses the lowering of the threshold to \$10,000.

***Option 3 - Net benefit***

The net result is that the benefits of improved cash flow (encouraging small businesses to reinvest in and grow their business) and reduced red tape outweigh the costs associated with this option, but to a lesser extent than in Option 2.

This option will result in an estimated total average annual regulatory saving for businesses of \$0.2 million:



**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. Consultation plan

The \$20,000 immediate deductibility threshold was introduced in the 2015-16 Budget, following extensive stakeholder consultation, which included the Board of Taxation, the ATO, small business stakeholder groups and professional tax and accounting bodies. It was subsequently extended in the 2017-18 Budget by 12 months to 30 June 2018.

Stakeholders have provided regular feedback on the effectiveness of the measure, most recently in response to the request for 2018-19 Pre-Budget Submissions. There is strong stakeholder support for extending the \$20,000 immediate deductibility threshold, including from stakeholders such as the Australian Chamber of Commerce and Industry, the Council of Small Business of Australia, Master Builders Australia, Chamber of Commerce and Industry Queensland, and Restaurant & Catering Australia.

## 6. Option selection/conclusion

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 2019 (Option 2).

## 7. Implementation and evaluation/review

Legislation is required to implement this proposal and will be administered by the ATO. Implementation is expected to be straight-forward, as it is a continuation of an existing measure.

Following the passage of the legislation, Treasury will continue to build into its broader small business consultation processes opportunities to seek views from small businesses about their practical experiences with the \$20,000 immediate deductibility threshold over the next 12 months. Treasury will also consider feedback from stakeholders as part of annual pre-budget submissions, which are expected to be received by the end of 2018.

Feedback from the ATO's engagement with small businesses in implementing the initiative, together with a further 12 months of data, would also be used to assess the benefits of this initiative and to inform the evaluation of the initiative, which would underpin any subsequent decision by government on the appropriate level of the threshold for the instant asset write-off.