The Path to a Bifurcated Tangible Asset Depreciation Regime in Australia

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More than two decades after their adoption, the rationale the generous depreciation concessions for small business remains unclear. Several after-the-fact explanations have been suggested, with the most common being a form of compensation for the proportionally high tax compliance burden borne by small businesses. It is, however, difficult to see how accelerated depreciation can provide appropriate offsets for compliance costs, particularly when the benefit is limited to profitable small businesses acquiring tangible property. Moreover, the emphasis on subsidising the acquisition of tangible assets seems misdirected given the 21st century trend towards deriving value from intangible assets and human capital. The small business depreciation system ultimately remains a concession in search for a plausible tax policy basis. This article provides a brief history of the Australian depreciation system to document how the small business depreciation concessions were adopted and how they have evolved to date, beginning with the legislative amendments that consolidated fragmented depreciation rules away from industry-specific tax expenditures in the 1990s. The article explains that the policy of concessions without logical policy objectives continues with more recent ad-hoc concessions, including the temporary COVID-19 measures.

I. Introduction

After eight and a half decades of a unified, albeit ever changing, depreciation system for business in Australia, at the turn of the 21st century Australia shifted to a bifurcated regime, with separate rules in place for large and small businesses, a policy that has remained in place until today. More than two decades later, a convincing rationale for the policy has yet to be articulated. Governments of both stripes nevertheless continue to support and regularly expand the concessional system adopted for small business. The story of how Australia ended up with this unique system and its policy implications is an important part of Australia's tax history.

The genesis of this story may be found two decades earlier, in the late 1980s when a fundamental shift in the Commonwealth Government's view of depreciation took place. From the adoption of Commonwealth income taxation in 1915 until that time, politicians across the spectrum regarded depreciation rules – the system for recognising the cost of wasting assets – as much as tool for implementing economic and social policy as a necessary rule to correctly measure taxable income.[1] Throughout the period, the depreciation rules were viewed by the legislature as tax expenditure measures that could be used to subsidise investments and activities favoured by the government of the day.

There was, however, a significant turning point in the policy in the early 1990s when the government, under the leadership of Paul Keating, pivoted away from the tax expenditure subsidies for particular industries or activities to a policy that favoured investment in tangible assets across the board. The generous universal concessions adopted by the Keating Government were retained in different forms for almost two decades until withdrawn at the turn of the century in favour of concessions targeted at one sector of the economy, the small business sector. Depreciation subsidies were delivered to businesses on

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[1] Christina Allen, "Australia's Capital Allowance Regimes between 1915 and 1992: Tax Law Becomes an Instrument of Economic Policy" (2022) 51(1) *Australian Tax Review* 25.

the basis of their size, not the industry to which they belonged or the type of depreciable property they acquired.

The rationale for directing subsidies at the small business sector was unclear, though many after-the-fact explanations have been offered, including the proportionally higher compliance costs borne by smaller businesses, the importance of small business to employment in Australia, and contributions of small business to innovation. There is no doubt that fixed compliance costs are proportionally higher as a percentage of income for small business.[2] Relief by way of depreciation concessions appears to be an odd response to mitigate the unequal impact, bypassing the many small business service providers with limited depreciable assets, as well as those in loss positions.

It is quite true that small business provides most employment in Australia but the employment is far less secure than that provided by large firms.[3] A subsidy that encourages enterprises to acquire tangible assets over employees may be an odd way to assist the sector in terms of employment objectives. And finally, while small business in Australia has demonstrated how agility and flexibility to respond to an ever evolving and changing economy has enabled firms to compete with the largest enterprises enjoying vast economies of scale never available to small business, it is not an innovative sector. It is big business that engages in research and development (R&D)[4] and it is big business developing innovation and new technology.[5]

Never stated by proponents of depreciation subsidies for small business, but patently obvious to political commentators, is the importance of the sector as voters, particularly in marginal seats on the outskirts of all metropolitan centres in the country. Whatever the notional or actual rationale or actual for depreciation subsidies for small business, the story of their development over the past three decades and the extent to which they have become firmly cemented into the Australian income tax system points to the very real possibility that Australia's income tax system is evolving into a bifurcated regime, with income tax rules for large business and a cash-flow expenditure tax for small business.

II. Transitioning to Modern Depreciation Regimes

Capital allowance rules were modified on numerous occasions, including special asset write-off rules that existed during World War II. Industry-specific concessions continued through the post-war reconstruction period that followed for several decades. In the early 1980s, a shift of policy was proposed by the conservative Fraser Government, based on a broad "5/3 depreciation" system that had been adopted in the United States a few years earlier.[6] The system replaced separate depreciation rules for

[2] See, eg, Philip Lignier and Chris Evans, "The Rise and Rise of Tax Compliance Costs for the Small Business Sector in Australia" (2012) 27(3) *Australian Tax Forum* 615; Phil Lignier, Chris Evans and Binh Tran-Nam, "Tangled Up in Tape: The Continuing Tax Compliance Plight of the Small and Medium Enterprise Business Sector" (2014) 29(2) *Australian Tax Forum* 217; Chris Evans et al, "Small Business and Tax Compliance Costs: A Cross-Country Study of Managerial Benefits and Tax Concessions" (2014) 12(2) *eJournal of Tax Research* 453.

[3] In 2020–2021, the net movement of business entries and exists shows an increase of 13.5% of employing businesses in Australia. The breakdown shows a 2.2% decrease in businesses going from employing to non-employing, a 15.2% increase in businesses with 1–4 employees, 7.6% increase in businesses with 5–19 employees, 20.6% of businesses with 20–199 employees (the largest increase), and an 8% increase in businesses with 200 or more employees. See Australian Bureau of Statistics, *Counts of Australian Businesses, including Entries and Exits* <https://www.abs.gov.au/statistics/economy/business-indicators/counts-australian-businesses-including-entries-and-exits/latest-release>.

[4] During 2019–2020, business expenditure on R&D was approximately $18,171 million in Australia. Using the number of persons within a business as an indicator of the business size, the R&D expenditure was incurred: 8.8% by businesses with 0–4 persons, 14.1% by businesses with 5–19 persons, 26.6% by businesses with 20–199 persons, and 50.5% by businesses with 200 or more persons. See Australian Bureau of Statistics, *Research and Experimental Development, Businesses, Australia, 2019-20* (Catalogue No 8104.0, 3 September 2021).

[5] During 2016–2017, 831,000 businesses were estimated to be involved in innovation in Australia. Using the number of persons within a business as an indicator of the business size, the number of businesses involved in innovation can be ranked, from the highest to the lowest, as businesses with 200 or more persons followed by businesses with 20–199 persons, businesses with 5–19 persons and businesses with 0–4 persons. See Australian Bureau of Statistics, *Innovation in Australian Business, 2016-17* (Catalogue No 8158.0, 19 July 2018).

[6] See David Brazell, Lowell Dworin and Michael Walsh, "A History of Federal Tax Depreciation Policy" (OTA Paper 64, Office of Tax Analysis, US Department of the Treasury, 1989).

individual assets with two wide accelerated depreciation bands of five and three years. Draft legislation for the proposal was inherited in 1983 by the newly elected Labor Government under Prime Minister Bob Hawke and Treasurer Paul Keating and somewhat surprisingly, with no apparent investigation and no explanation offered, the Labor Government adopted the measure shortly after forming government.[7]

The Labor Government quickly pivoted after coming to grips with the economic challenges facing the country and over the course of a few years, the government oversaw a dramatic overhaul of the nation's economic foundations, shifting the economy from a closed and highly protected model to one that was fully engaged with the global economy, following removal of capital controls, floating of the currency, and a dramatic winding back of tariffs. Tax changes were equally dramatic with the adoption over a short period capital gains taxation and fringe benefits taxation as well as a significant modernisation of the income tax including adoption of an imputation system giving shareholders credits for taxes paid by the companies in which they held shares and the removal of an exemption for income derived abroad.

In this context, the broad depreciation concession adopted in 1983 was particularly anomalous and in an Economic Statement released in May 1988,[8] the government announced the accelerated depreciation would be wound back and a range of other investment incentives wound back.[9] Legislation adopted soon after replaced the 5/3 depreciation with depreciation of assets over their effective lives, using either straight line or declining balance methodology.[10] At the same time, it expanded a depreciation "loading" that the previous government had introduced in 1981. Originally introduced as a mechanism to increase annual depreciation by 20%, the previous government had decreased the acceleration percentage to 18%.[11] The Hawke Government reinstated the original percentage of the loading to allow accelerated depreciation by 20% of the effective life rate,[12] with the goal of stimulating new investment[13] In addition, the two depreciation rates for buildings then in place, 25 or 40 years, were consolidated into a single 40-year life on a straight-line basis.[14]

A. Fightback! versus One Nation

In 1990, Australia faced high levels of unemployment, high levels of government debt and a very troubling trade balance. The Coalition Opposition sought to capitalise on these economic woes with a 650-page economic manifesto titled *Fightback!*[15] released in November 1991, a pre-election policy platform best known for its ill-fated proposal to adopt Goods and Services Taxation (GST).[16] In February 1992, Paul Keating, stepped up from Treasurer to Prime Minister, released the Labor's response to *Fightback!*, a four-year economic reform program called *One Nation*.[17] In *One Nation*, the Labor

[7] *Income Tax Assessment Act 1936* (Cth) s 57AL, inserted by *Income Tax Assessment Amendment Act 1983* (Cth) s 15.

[8] Treasurer, *Economic Statement: May 1988* (Commonwealth of Australia, 1988) (*Economic Statement: May 1988*).

[9] *Taxation Laws Amendment Act (No 4) 1988* (Cth), scaling back the 5/3 depreciation system that allowed deductions of long-lived assets for either three or five years (including grain, hay or fodder storage facilities and new primary production plant), special depreciation and investment incentives applicable to the Australian trading ships, and immediate deductions of the costs incurred in installing mains electricity connections on rural properties (ss 33–35, 38–39, 43, 54).

[10] *Taxation Laws Amendment Act (No 4) 1988* (Cth), repealing *Income Tax Assessment Act 1936* (Cth) ss 57AE, 57AH, 57AL.

[11] *Income Tax Assessment Act 1936* (Cth) s 57AG, amended by *Income Tax (Assessment and Rates) Amendment Act 1981* (Cth) s 8. Section 57AG was initially inserted by the *Income Tax Assessment Amendment Act (No 4) 1980* (Cth), which allowed 20% loading.

[12] *Taxation Laws Amendment Act (No 4) 1988* (Cth), amending *Income Tax Assessment Act 1936* (Cth) s 57AG. See also Australian Government, *Tax Expenditures Statement: October 1986* (Commonwealth of Australia, 1986). Section 57AG was considered a tax expenditure (24) and the inflationary effects on depreciation was illustrated at 38–89.

[13] *Economic Statement: May 1988*, n 8, 7.

[14] *Income Tax Assessment Act 1936* (Cth) Divs 10C, 10D.

[15] Liberal and National Parties of Australia, *Fightback! It's Your Australia* (Policy Statement, 21 November 1991) (*Fightback! It's Your Australia*); Liberal and National Parties of Australia, *Fightback! Taxation and Expenditure Reform for Jobs and Growth: The Liberal and National Parties' Plan to Rebuild and Reward Australia* (Policy Statement, 21 November 1991).

[16] See John Quiggin, "Fightback and One Nation: A Comparative Analysis" (1992) 9(2) *Australian Tax Forum* 127.

[17] Paul Keating, *One Nation: Statement by the Prime Minister* (Statement by the Prime Minister, 26 February 1992) (*One Nation*).

Government reinstated its role to create jobs and build strong economy, while noting its achievements of the 1980s as strong foundations it had built for this task.[18]

Although the Coalition was concerned with market distortions led by accelerated depreciation,[19] *Fightback!* promised review of tax depreciation rules to match international practice without specifics.[20] In contrast, *One Nation* included details of the depreciation rules for plant and articles as well as buildings and structural improvements.[21] Industries welcomed the Labor's proposals,[22] and the government moved ahead to make several changes to the capital allowance regimes under the *One Nation* program, with most taking effect after 26 February 1992, the date the policy was announced.

Changes to the depreciation rules of plant and articles took place alongside a shift in tax administration from a full assessment regime to a self-assessment model, a process that took four amending Acts in 1992 and a fifth the following year.[23] The revised depreciation regime had three limbs. First, the item-by-item depreciation rates fixed by the Commissioner was replaced with a self-assessment regime that allowed taxpayers to nominate effective life periods for their assets.[24] The Commissioner's depreciation schedule, which had been mandatory previously, was recast as a safe harbour rule, with taxpayers allowed to adopt faster write-offs if they could demonstrate a reasonable basis for predicting a shorter life span for an asset. Second, wide-ranging (self-assessed) depreciation periods were fit into one of the six bands[25] for assets other than motor vehicles and artworks or seven bands for motor vehicles.[26] This was called "broad-banding".[27] Immediate deductions were allowed for low-cost assets costing up to $300 and short-lived assets with an estimated effective life of less than three years.[28] Third, special rules were introduced for assets used in scientific research and assets (principally) used to provide clothing cupboards, first aid, rest rooms, recreational facilities, meals or eating facilities for employees and their children in onsite

[18] *One Nation*, n 17, 3.

[19] Brereton of the Australian Labor Party called this Coalition's view "dogmatic": House of Representatives, *Parliamentary Debates*, 2 June 1992, 3354–3355 (Laurence J Brereton).

[20] *Fightback! It's Your Australia*, n 15, 5, 49.

[21] *One Nation*, n 17, 71–77, 88–89, 106.

[22] The tourism industry particularly welcomed the proposal of new depreciation rules in *One Nation*: see, eg, Australian Labor Party, *Poles Apart on Australia's Future: It's Your Choice* (Political Party Document, 1991) 104. The "One Nation" policy supported accelerated depreciation of hotels, motels and residential property used for short-term accommodation, as the tourism industry was the single largest earner at the time and deregulation of the domestic aviation sector was expected to generate significant economic growth. See *One Nation*, n 17, 74, 88, 106.

[23] *Taxation Laws Amendment Act 1992* (Cth); *Taxation Laws Amendment Act (No 2) 1992* (Cth); *Taxation Laws Amendment Act (No 3) 1992* (Cth); *Taxation Laws Amendment Act (No 5) 1992* (Cth); *Taxation Laws Amendment Act 1993* (Cth).

[24] *Taxation Laws Amendment Act 1992* (Cth) s 16, inserting *Income Tax Assessment Act 1936* (Cth) s 55. The rates were for applying the diminishing value method and to apply the prime cost method, they had to be read together with s 56(1). This time, "horticulture" was added to ensure that primary production, for which structural improvements were depreciable, would include horticultural activities: *Taxation Laws Amendment Act (No. 2) 1992* (Cth) s 4, amending *Income Tax Assessment Act 1936* (Cth) s 6(1).

[25] It was initially a seven-band scale but settled on six bands in response to industry consultations. The broad-banding schedule for motor vehicles remained with seven bands. The amendment to a seven-band scale was considered unnecessary because effectives of lives of motor vehicles were unlikely to go beyond 10 years. See Explanatory Memorandum, *Tax Laws Assessment Bill (No 2) 1992* (Cth) [1.21].

[26] *Income Tax Assessment Act 1936* (Cth) s 55. For administrative convenience, taxpayers were allowed to combine some or all assets in a pool to apply the diminishing value method. Assets could exit the pool separately, provided the depreciated value was ascertainable. See *Income Tax Assessment Act 1936* (Cth) s 62AAB–AAV.

[27] For example, the highest band of under the six-band system, for assets with an effective life greater than 30 years, was capped at approximately 14.3 years. However, the depreciation period of a motor vehicle with an effective life of seven years was approximately 6.7 years, compared to a five-year depreciation period under the general broadbanding schedule. This was because the general broad-banding schedule incorporated the 20% loading to further accelerate depreciation. Artwork was not subject to broad-banding but was depreciable with the 20% loading: for example, a 100-year-old artwork would be depreciable at an annual rate of 1.2% on a straight line, or 1.5% annually using the diminishing value method.

[28] *Income Tax Assessment Act 1936* (Cth) s 55.

child care facilities to allow accelerated depreciation by applying a 50% annual depreciation rate and using the diminishing value method, or 33⅓% for straight line depreciation.[29]

Depreciation rules for buildings and structural improvements had two notable effects. First, the 40-year depreciation period of income-producing buildings was shortened to 25 years.[30] Buildings used partially for income-producing purposes and to buildings located overseas but used to generate income assessable in Australia were also included in this system.[31] Second, a 40-year depreciation system was introduced for infrastructural assets such as roads, fences, carparks, tennis courts and sheds,[32] some of which were already depreciable for primary producers and none of which had been depreciable for other businesses until that point.[33] However, this system excluded mains electricity assets used for carrying on a business and telephone line assets used in primary production businesses, which remained subject to their own 10-year depreciation regimes introduced under the industry-focused depreciation tax policy.[34]

A parallel development was the adoption by the Keating Labor Government of a temporary investment allowance regime that enhanced depreciation deductions with an upfront deduction in addition to full depreciation of the cost of eligible plant equal to 10% of the depreciation otherwise allowed. Eligible plant was defined as any new plant used in a large-scale project worth at least $50 million (effectively, this meant mining projects), if expenditure was incurred after 26 February 1992, and if the plant was first used or installed and ready to use before 1 July 2002. Eligibility had to be confirmed by way of certification by a newly established Development Allowance Authority.[35] The following year, continuing enthusiasm for tax concessions for depreciable assets led to the adoption of a general 10% investment allowance not limited to large projects.[36] This general allowance applied to investment in new plant acquired after 8 February 1993 and before 1 July 1994 that cost at least $3,000 and was first used or installed before 1 July 1995.

The tax concessions provided under *One Nation* were small compared to the economic incentives provided through taxation before the terms of the Hawke-Keating Labor Government.[37] In response to *One Nation*, the Coalition released a revised version of *Fightback!* in December 1992 with an emphasis on fairness and jobs, which included an attack on Labor's industry-friendly tax depreciation rules based on effective lives and that those rules did little to boost the economy without fully-fledged proposals to counter them.[38] While the proposed GST, the centrepiece of *Fightback!*, was expected to shift the tax

[29] *Income Tax Assessment Act 1936* (Cth) s 55. In effect, the previous rules for employee amenities – ie, clothing cupboards, first aid, rest-room or recreational facilities, or meals or facilities for meals – were largely rewritten in the same provision.

[30] *Taxation Laws Amendment Act (No 3) 1992* (Cth) ss 39, 41 (*1992 Act*) amended *Income Tax Assessment Act 1936* (Cth) ss 124ZA, 124ZC (traveller accommodation). Sections 47, 79 of the *1992 Act* amended *Income Tax Assessment Act 1936* (Cth) ss 124ZF, 124ZH (industrial buildings). Also, this Act separated traveller accommodation from income-producing buildings in a "resurrected" Div C of Pt III of the *Income Tax Assessment Act 1936* (Cth).

[31] *Taxation Laws Amendment Act (No 3) 1992* (Cth) ss 39–40, 49, amending *Income Tax Assessment Act 1936* (Cth) ss 124ZA–124ZB, 124ZH.

[32] *Income Tax Assessment Act 1936* (Cth) Div 10D.

[33] See, eg, *Case C59* (1952) 3 TBRD 311 (brick manufacturing sheds – building); *Case K96* (1959) 10 TBRD 519 (shopping centre parking area); *Case P43* (1964) 14 TBRD 193 (squash courts); *Case S25* (1966) 17 TBRD 144 (brick drying sheds); *Moreton Central Sugar Mill Co Ltd v Commissioner of Taxation (Cth)* (1967) 116 CLR 151 (a pit in the ground); *Case A81* 69 ATC 439 (concrete slabs to sit metal ores stockpiled); *Case G12* 75 ATC 47 (fencing); *Case T102* 86 ATC 1178 (swimming pool designed for scuba diving lessons); *Case M13* 80 ATC 87 (transportable laboratories affixed to the site building).

[34] *Income Tax Assessment Act 1936* (Cth) ss 70, 70A.

[35] *Taxation Laws Amendment Act (No 3) 1992* (Cth) ss 61–78, replacing *Income Tax Assessment Act 1936* (Cth) Pt III Div 3 Subdiv B.

[36] *Taxation Laws Amendment Act (No 2) 1993* (Cth) s 23, inserting *Income Tax Assessment Act 1936* (Cth) Pt III Div 3 Subdiv BA.

[37] Quiggin said that *One Nation* was "a political document … while maintaining [their] policies essentially unchanged". See Quiggin, n 16, 147.

[38] Liberal and National Parties of Australia, *Fightback! Fairness and Jobs* (Liberal National Parties, 18 December 1992) 31–32. However, R&D incentives were mentioned at 33. See also Kathryn James, "We of the 'Never Ever': The History of the Introduction of a Goods and Services Tax in Australia from 1970 to 2005" in *John Tiley* (ed), *Studies in the History of Tax Law, Volume 3* (Bloomsbury Publishing, 2009) 162.

burden from large businesses to small businesses,[39] right before the 1993 election, the Coalition leader severely fractured its prospect for winning the election by failing explain to the public how GST would practically work and ultimately lost the "seemingly 'unlosable' election".[40]

After the re-election, more changes were made to the depreciation rules. In 1993, an accelerated four-year depreciation rule, which had not been announced previously, was adopted for long-life grapevines, commencing from the year in which the vine was first used for income-producing purposes (generally, the establishment year).[41] As recommended by the Industry Commission,[42] the six broad-banding rates adopted for plant and articles in 1992 were also availed to horticultural plantations.[43] These measures allowed deductions for costs incurred in producing assessable income which could be denied by reason of judicial characterisation of the costs as capital expenditure.

R&D incentives were also attended to increase productivity and international competitiveness. Previously, additional deductions for R&D plant, adopted in 1986, were subject to a shade-in formula, for expenditure between $20,000 and $50,000, exclusive.[44] In 1994, the shade-in rates were abolished to provide the full 50% additional deduction for R&D plant when annual aggregate R&D expenditure exceeded $20,000.[45] In 1996, the depreciation regime was expended to *pilot plant* used in R&D – experimental versions of plant used in the production of income.[46] Previously, pilot plant was only depreciable for three years and up to $10 million. The removal of the three-year limit on depreciation deductions resulting pilot plant treated in the same way as regular plant and articles, subject to depreciation over an effective life period.

Furthermore, an investment allowance was newly adopted in 1995 for plant acquired for drought mitigation was a specific industry assistance measure. This measure allowed a 10% augmentation of deductible costs in relation to assets costing between $3,000 and $50,000, inclusive, acquired from 24 March 1996 and used or installed for use by 30 June 2000.[47]

B. Taxation Law Improvement Project

The Labor Government of 13 continuous years came to an end when the opposition Coalition under the leadership of John Howard was elected to government in 1996. The Howard Government had fiscal and tax reforms as the touchstones of its policies during the nine years in office.[48] It particularly focused on spending cuts[49] turn the inherited budget deficit to surplus although its ultimate success has been questioned as to whether it should be credited to the policies or fortune to be in office at the right time.[50] During this time, two structural capital allowance reforms were carried out.

[39] Quiggin, n 16, 139.

[40] Emily Sakzewski, "The Mike Willesee Question that Turned the 'Unlosable Election'" (ABC News, 1 March 2019).

[41] *Taxation Laws Amendment Act (No 3) 1993* (Cth) s 115, inserting *Income Tax Assessment Act 1936* (Cth) s 75AA.

[42] Industry Commission, Parliament of Australia, *Horticulture* (Report No 29, 18 February 1993) 102–104.

[43] *Taxation Laws Amendment Act (No 4) 1995* (Cth) Sch - 4, inserting *Income Tax Assessment Act 1936* (Cth) Pt III Div 10F.

[44] *Income Tax Assessment Amendment (Research and Development) Act 1986* (Cth).

[45] *Taxation Laws Amendment Act (No 4) 1994* (Cth) Sch 4 ss 14–18, amending *Income Tax Assessment Act 1936* (Cth) s 73B.

[46] *Taxation Laws Amendment Act (No 3) 1996* (Cth) Sch 4 ss 39–50, amending *Income Tax Assessment Act 1936* (Cth) s 73B.

[47] *Taxation Laws Amendment (Drought Relief Measures) Act 1995* (Cth), inserting Pt XII into the *Income Tax Assessment Act 1936* (Cth). A drought mitigation asset was defined as a fodder storage facility, water storage facility, water transport facility or minimum tillage equipment.

[48] Alan Fenna, "Governing in Good Times: Fiscal Policy and Tax Reform in Australia: 1996-2006" (2007) 42(2) *Journal of Political Science* 329.

[49] For example, Whiteside said, "In Australia, we see the Labor Party initiating the 1990s era of austerity in 1994 through revenue-based measures, but when the Liberal Party took over in 1996 this switched to expenditure cuts, namely health and social security": Heather Whiteside, "Neoliberalism as Austerity" in Simon Springer, Kean Birch and Julie MacLeavy (eds), *Handbook of Neoliberalism* (Taylor & Francis Group, 2016) 364.

[50] Fenna, n 48. Arguably, it is difficult to conclude that Australia's success of economic performance in the 1990s was due to neoliberal policies. See John Quiggin, "Looking Back on Microeconomic Reform: A Sceptical Viewpoint" (2014) 15(1) *The*

The first reform was under the legislative rewrite initiative called the Taxation Law Improvement Project (TLIP) inherited from the Labor Government.[51] In 1993, the Labor Government embraced the idea of a "plain English" redraft of the law, which was recommended by the Joint Committee of Public Accounts and Audit.[52] A team of experts from the Australian Taxation Office and Office of Parliamentary Counsel were appointed to design a new Act. The team's mandate was to simplify the tax laws by redrafting the legislation to improve "understanding of the law, its expression and its readability".[53] The terms of reference did not include making substantive changes to the law, but over the course of the project, they were interpreted to include changing the structure of the legislation.[54]

The Howard Government announced its plan to continue the TLIP.[55] In 1996, a framework for the revised depreciation regime was set out in the new *Income Tax Assessment Act 1997* (Cth) (*1997 Act*), the first tranche of TLIP legislation.[56] The rewritten Act contained three core Divisions dealing with depreciation: Division 40, the overview; Division 41, which contained "common rules";[57] and Division 43, which contained rules about "capital works". However, in practice, these new Divisions had limited substantive effect. Division 40 simply listed all the depreciation rules in the *Income Tax Assessment Act 1936* (Cth) (*1936 Act*) and cross-referenced them to section numbers in the new Act. Division 41 reproduced some of the previous rollover rules for the mining and quarrying industries, as well as including some supplementary anti-avoidance rules for non-arm's length transfers. Only Division 43 contained a relatively comprehensive rewrite of the original rules. It consolidated, to an extent, the rules for traveller accommodation (defined as "hotel building" in the *1997 Act*), some of the depreciation rules for other income-producing buildings and the rules for structures connected to real property (including roads, pipelines, retaining walls, fences, and similar assets) into one Division. However, the separate rules for different types of capital works largely remained intact and the depreciation rules for primary production buildings remained in the primary production depreciation provisions in the *1936 Act*.

A second tranche of TLIP legislation, adopted later in 1997, shifted the depreciation rules for plant and articles (simply called "plant" in the new Act,[58] but retaining the same broad definition that includes "articles" as in the previous Act)[59] into new Division 42. The maximum 25-year depreciation rules for forestry roads and timber mill buildings were also moved into the *1997 Act*[60] (while timber industry employee accommodation was incorporated into the definition of plant), along with the several deduction rules for: land improvements,[61] water conservation measures,[62] grapevines,[63] electricity[64] and telephone

Economic and Labour Relations Review 1; John Quiggin, "The Australian Productivity Miracle: A Sceptical View" (2001) 8(4) *Journal of Policy Analysis and Reform* 333.

[51] Ralph Willis, Treasurer, "Tax Law Improvement Project" (Press Release, 17 December 1993).

[52] The genesis of the project is described in Mark Burton and Michael Dirkis, "Defining Legislative Complexity – A Case Study: The Tax Law Improvement Project" (1995) 14(2) *University of Tasmania Law Review* 198.

[53] Australian Taxation Office, Tax Law Improvement Project, *Information Paper No 1: The Broad Framework* (August 1994).

[54] Explanatory Memorandum, *Income Tax Assessment Bill 1996* (Cth); *Income Tax (Consequential Amendments) Bill 1996* (Cth); *Income Tax (Transitional Provisions) Bill 1996* (Cth) (see "Background" 1).

[55] Jim Short, Assistant Treasurer, "Government Welcomes Support of Public Accounts Committee for New Income Tax Law" (Press Release, 22 August 1996).

[56] *Income Tax Assessment Act 1997* (Cth) (Act No 38 of 1997).

[57] *Income Tax Assessment Act 1997* (Cth) Div 41.

[58] *Tax Law Improvement Act 1997* (Cth) (Act No 121 of 1997).

[59] *Income Tax Assessment Act 1997* (Cth) s 42-18.

[60] *Income Tax Assessment Act, 1997* (Cth) Subdiv 387-G, inserted by *Tax Law Improvement Act 1997* (Cth). The depreciation period was for the duration of timber operations or 25 years, whichever was lesser.

[61] *Income Tax Assessment Act, 1997* (Cth) Subdiv 387-A, inserted by *Tax Law Improvement Act 1997* (Cth).

[62] *Income Tax Assessment Act 1997* (Cth) Subdiv 387-B, inserted by *Tax Law Improvement Act 1997* (Cth).

[63] *Income Tax Assessment Act 1997* (Cth) Subdiv 387-D, inserted by *Tax Law Improvement Act 1997* (Cth).

[64] *Income Tax Assessment Act 1997* (Cth) Subdiv 387-E, inserted by *Tax Law Improvement Act 1997* (Cth).

connections for businesses on the rural land and primary producers.[65] The land improvement outright deduction measures were called the "landcare" provisions, which arguable gave the Act's environmental credentials. The water conservation measures were changed to accelerate depreciation from five years to three years, with an added safeguard that allowed a one-time-only deduction for expenditure on every asset.[66] None of these measures were included in the depreciation rules part of the Act. Rather, they were inserted into a separate part reserved for "particular industries and occupations".[67]

In 1998, a third tranche of TLIP legislation moved the horticultural depreciation rules into the *1997 Act*.[68]

The shift to the new legislation was not intended for conceptual simplification. While the language of the rules changed, their complex structure did not. Despite so-called "common" rules, many of the rules, such as the primary production depreciation provisions, were placed in different parts of the *1997 Act*. Meanwhile, after 1998, the TLIP largely stalled as drafting resources were redeployed to prepare the new GST legislation and, from mid-1999, for a business tax review.

III. The Review of Business Taxation and 21st Century Shift to Bifurcated Tax Depreciation

In mid-1998, two years after the Coalition returned to power under the leadership of John Howard, the government announced its intention to restructure Australia's tax system with the adoption of a broad-based consumption tax, the GST that would be used in part to fund reductions in income tax rates. The following day, the Treasurer, Peter Costello, announced the appointment of a committee to review income tax system as it applied to businesses in Australia. Soon afterwards, the government called an election to secure popular support for the tax and following its re-election in October of that year, put in motion the machinery to draft the GST legislation while the business tax review, formally known as the Review of Business Taxation (RBT) under the chairmanship of a leading business figure, John Ralph, began preparation of its report.

While the review was empowered to provide the government with advice on all aspects of business taxation, its focus according to the terms of reference was to find a way of funding a reduction in the company income tax rate to 30% and substantial reductions in the tax imposed on capital gains.[69]

Apart from these two specific goals, the review was broadly tasked to consider reform of the general business taxation system. The Terms of Reference made no mention of special rules for small business and the RBT's initial discussion papers setting out the framework for the report made no mention of special rules for small business.[70] The only discussion of depreciation discounted substantially arguments in favour of accelerated depreciation while explaining the logic of concession-free rules based on effective life.

However, some participants in the process were aware of the report of the Small Business Deregulation Task Force appointed by the Howard Government shortly after its first election to power in 1996, charged with reducing small the business regulatory burden by 50%.[71] The Task Force's report published six months later had identified tax compliance as one of regulatory burden for small business, citing

[65] *Income Tax Assessment Act, 1997* (Cth) Subdiv 387-F, inserted by *Tax Law Improvement Act 1997* (Cth).

[66] *Income Tax Assessment Act 1997* (Cth) s 387-140.

[67] *Income Tax Assessment Act 1997* (Cth) Div 387, inserted by *Tax Law Improvement Act 1997* (Cth).

[68] *Income Tax Assessment Act 1997* (Cth) Subdiv 387-C, inserted by *Tax Law Improvement Act (No 1) 1998 (No 46 of 1998)* (Cth).

[69] See Review of Business Taxation, A Tax System Redesigned: More Certain, Equitable and Durable (Report, 1999) v (*RBT Final Report*). In the original terms of reference, the former had a narrower scope to review company taxation arrangements of all limited liability entities, instead of "business entities". See Peter Costello, Treasurer, "Business Income Tax Consultation" (Press Release, 14 August 1998). These terms of reference were amended on 27 October 1998, 2 June 1999 and 17 June 1999.

[70] Review of Business Taxation, *A Platform for Consultation: Building on a Strong Foundation* (Discussion Paper 2, Vol 1, November 1999) Chs 1–2 (*RBT Discussion Paper*).

[71] John Howard, Prime Minister, "Small Business Deregulation Task Force" (Press Release, 2 May 1996). Small Business Deregulation Task Force, *Time For Business* (Commonwealth of Australia, Report, November 1996) vii. See also John Harrison, *Total Tax Review: Major Reform Issues* (Parliament of Australia, Current Issues Brief 7, 1996–1997).

complexity, uncertainty and difficult interpretation of the tax law as drivers for compliance costs.[72] As a consequence, although there was no mandate in the RBT's Terms of Reference to investigate the compliance burden of small business, one group in the review turned its attention to this question and development of a new small business regime emerged as one of the RBT's programs. At the same time, the main group continued a focus on broader depreciation and tax neutrality rules.

The final recommendations of the Review of Business Taxation covered a wide range of business taxation topics. Apart from the recommendation for a reduced rate of taxation for capital gains sought by the government, for the most part the Report emphasised the importance of an economically neutral income tax and many elements of the Report made great efforts to better align taxable income and accounting profits or, as the Report labelled it, tax value and commercial value.[73] Somewhat inconsistent with the general thrust of the Report, and not foreshadowed in the RBT's foundation documents or Terms of Reference, the report proposed the adoption of a distinct business tax system for small business, including a depreciation regime that would likely sit separate to the ordinary depreciation system and one that was a substantial departure from any commercial method of accounting for expenses.

A. The RBT and Reform of the General Depreciation System

The RBT's final report proposed important structural and substantive changes to the depreciation system. The structural changes took the form of a long-overdue reorganisation and consolidation of the depreciation rules, which had by that time, been transferred into the 1997 version of the income tax legislation (although, as noted earlier, they were located in both the depreciation sections and divisions reserved for special industries).[74] The most significant substantive change was the removal of accelerated depreciation concessions and the restoration of effective lives, changes intended in part to fund large reductions in the company tax rate and a minor, almost token, reduction in the individual income tax rate.[75] A further substantive change was an overhaul of the balancing charge rules to eliminate the distinction between depreciation recapture and capital gains recognised on the sale of depreciable property for more than original cost.[76] and a final substantive change was the expansion of the depreciation rules to allow depreciation of previously unrecognised "black hole" expenses.

1. Restructuring the Legislation

Following the recommendation by the RBT, the government introduced the so-called "uniform capital allowance" regime under which at least 27 capital allowances were consolidated in 2001.[77] This post-RBT structure of the depreciation rules reflected a level of consistency and logic that had been absent up

[72] Small Business Deregulation Task Force, n 71, Ch 3.

[73] This was outlined in the Terms of Reference in *RBT Final Report*, n 69, v (see para 3(b)(ii)).

[74] *RBT Final Report*, n 69, 308–309 (Recommendation 8.2: uniform treatment for depreciable assets).

[75] *RBT Final Report*, n 69, 305–308 (Recommendation 8.1: removal of accelerated depreciation). The marginal tax rates for resident taxpayers were marginally decreased for taxable income in excess of $20,701 in 1994–1995. The tax rate bracket thresholds were not indexed for individual taxpayers, although Australia had experienced a stable period of inflation around 2%–3% since the 1990–1991 recession, the medium-term target rate set by the Reserve Bank Australia in 1993 and officially endorsed by the government in 1996 – see further Andrew Glassock, "70 Years of Inflation in Australia" (Australian Bureau of Statistics, 2018); Guy Debelle, "Twenty-Five Years of Inflation of Inflation Targeting in Australia" (Reserve Bank of Australia Conference 2018, Sydney, 12 April 2018); The Treasurer and the Governor (Designate) of the Reserve Bank, "Statement on the Conduct of Monetary Policy" (Reserve Bank of Australia, 14 August 1996). The individual income tax rates remained stable until the tax bracket thresholds were decreased in 1999–2000 (to be funded out of newly introduced GST) before jumping back up in 2003–2004 (to compensate for bracket creep). In contrast, the corporate tax rate was significant cut, from 36% to 34% in 2000–2001 and to 30% in 2001–2002. See further Guy Redden, "John Howard's Investor State: Neoliberalism and the Rise of Inequality in Australia" (2019) 45(4–5) *Critical Sociology* 713, 713, 717 (stating that the Howard Government was bent towards the rich, leading Australia to become an "investor state".). Conversely, the Australia managed its social systems well to result in minimal impact on income inequalities according to Alan Tapper, "The Performance of the Australian Welfare System in a Time of Neoliberal Economic Reform" (2019) 53(5) *Social Policy & Administration* 641.

[76] *RBT Final Report*, n 69, 318–320 (Recommendation 8.11: taxation upon disposal of depreciable asset).

[77] The number of consolidated capital allowances was mentioned in Explanatory Memorandum, *New Business Tax System (Capital Allowances) Bill 2001* (Cth); *New Business Tax System (Capital Allowances – Transitional and Consequential) Bill 2001* (Cth).

to that point but retained several conceptual shortcomings from the previous regime, including keeping movable property entirely separate from capital assets attached to land. However, significant strides were made in creating a principle-based structure, with a set of core rules created for "depreciating assets", defined as assets with a limited effective life that can reasonably be expected to decline in value.[78]

The first step in the restructure was reorganising most of the depreciation rules (other than the rules for capital works) and immediate deduction rules into a new division.[79] Divisions 40 (the overview provisions), 41 (the common rules) and 42 (the actual depreciation rules) were all repealed and replaced with new Division 40 that contained all three of these, plus many of the industry or investment-specific rules. This brought together, for the first time, almost all the depreciation rules, from plant to electricity and telephone lines, grapevines and landcare expenditure.[80] Parallel legislation adopted at the same time set out transitional rules to help taxpayers shift to the new rules.[81]

The most important legislative departure from the principles set out by the RBT was in respect of buildings and other capital works. Consistent with its benchmark proposals, the RBT had recommended the rules for depreciating the cost of new buildings be merged into the ordinary depreciation rules and be subject to the ordinary effective life rules, like other depreciable assets.[82] These recommendations were rejected by the government and the post-RBT rewrite of the depreciation rules retained an entirely separate division for buildings and other capital works (albeit with forestry roads and timber mill buildings included in the depreciated rules, as a result of reorganising the industry-specific rules).[83]

2. Returning to Depreciation Based on Effective Life

Apart from structural and principle-based reforms, the primary focus of the RBT's recommendations on depreciation was eliminating the costly and, in the RBT's view, inefficient accelerated depreciation options, which had been used to fund a reduction in the company tax rate from 36% to 30%, with an interim rate of 34% for one year.[84] The RBT called for equitable treatment between different types of depreciable assets but, recognising the inevitability of concessions, argued there should be transparent explanations for any exceptions to the rules.[85]

The first step in reforming the accelerated depreciation rules was to end the broad-banding and loading concessions that had been adopted in 1992 and reinstate depreciation based on the effective life of assets.[86] This also required effective life to be recalculated when the costs incurred on an asset in a given year increased the asset's cost base by 10% or more, unless the taxpayer used straight line depreciation based on an effective life determined by the Commissioner.[87] However, not all the depreciation concessions were removed. To simplify the system, immediate deductions were retained for low-cost assets (less than $300) used for producing assessable income, other than income from carrying on a business.[88] Another simplification rule allowed taxpayers to pool expenditure for assets costing between $300 and $1,000 or a depreciated value less than $1,000, and depreciate the pooled costs at 18.75% for newly acquired

[78] *Income Tax Assessment Act 1997* (Cth) s 40-30.

[79] *New Business Tax System (Capital Allowances) Act 2001* (Cth).

[80] Departures from benchmark depreciation have been deliberate, with specific tax concession rules enacted to encourage particular types of investment and advance certain social and economic policy objectives. See the Australian tax policy dynamics in Richard Eccleston, "The Tax Reform Agenda in Australia" (2013) 72(2) *Australian Journal of Public Administration* 104.

[81] *New Business Tax System (Capital Allowances – Transitional and Consequential) Act 2001* (Cth).

[82] *RBT Final Report*, n 69, [236]–[238], 321–325 (recommendations 8.12–8.14).

[83] *New Business Tax System (Capital Allowances – Transitional and Consequential) Act 2001* (Cth) Sch 2 s 227, inserting *Income Tax Assessment Act 1997* (Cth) s 43-72.

[84] The matching of depreciation reform and the reduction in the company tax rate was set out in the RBT's initial discussion paper: *RBT Discussion Paper*, n 70, 69. The recommendation for a phased reduction was made in the *RBT Final Report*, n 69, 425.

[85] *RBT Final Report*, n 69, 308.

[86] *Income Tax Assessment Act 1997* (Cth) s 40-95.

[87] *Income Tax Assessment Act 1997* (Cth) s 40-110(2)–(3).

[88] *Income Tax Assessment Act 1997* (Cth) s 40-80(2).

assets in the first year and 37.00% in all other cases. However, excluding low-cost business assets from this simplification measure was an anomaly.[89]

A range of industries were allowed to keep the special depreciation concessions from which they had benefited in the past, outside the broad-banding concession. Retained concessions included the statutory cap on effective life periods for airplanes, vehicles and ships and assets used in gas supply, oil and gas extraction, petroleum refining and primary production.[90] Also retained were the existing depreciation concessions available under industry-specific regimes such as the three-year depreciation period for plant and structural improvements for conserving or conveying water,[91] four-year depreciation for grapevines[92] (which was subsequently removed three years later),[93] accelerated depreciation for horticultural plants,[94] outright deductions for capital expenditure incurred in landcare operations and the 10-year depreciation period for the cost of electricity and telephone line connections.[95] An important exception to the special concessions that were retained was the rule for plant exclusively used in R&D. The three-year depreciation period for R&D plant adopted in 1986 (which, from 1996, excluded pilot plant), reverted to a period based on effective life,[96] combined with an extended scope for eligible plant including plant partly used for R&D. This applied retrospectively, from 1 July 1985 onwards; plant was subject to additional deductions of 125% when total annual R&D expenditure was greater than $20,000.[97]

Two more new measures were introduced at this time to promote investment in R&D business. The first changed tax deductions into tax credits, to provide immediate cash flow benefits to taxpayers in the growth stage who incurred annual R&D expenditure of over $20,000 in total.[98] To be eligible, taxpayers and their affiliates had to incur R&D expenditure of less than $1 million in total and have a turnover of less than $5 million in the relevant tax year, calculated based on the value of supplies. The second new measure was an additional 50% deduction on any R&D investment greater than the taxpayer's average level of spending in the current and prior two years. Lease expenditure and any other expenditure on plant were excluded when calculating this concession.[99]

3. Modified Depreciation Recapture Rules

The change to the balancing adjustment system was directly tied to the changes made to the capital gains rules. Since 1924, when balancing charge rules were first adopted, the measures had distinguished between income recapture (comparing book value to original cost) and capital gains (comparing the original cost to the proceeds of disposal).[100] Prior to 1985, a capital gain was exempt from tax unless

[89] The Commissioner allowed expenditure incurred to acquire a business asset up to $100 to be deductible in the year in which it is incurred: see Australian Taxation Office, *Practice Statement Law Administration: Practical Approaches to Low-Cost Business Expenses* (PS LS 2003/8, 16 September 2003).

[90] *Income Tax Assessment Act 1997* (Cth) ss 40-102, 40-103.

[91] *Income Tax Assessment Act 1997* (Cth) Subdiv 40-F. The subdivision traditionally encouraged drought preparedness. See, eg, *AJ & PA McBride Ltd v Federal Commissioner of Taxation* (2020) 111 ATR 890; [2020] AATA 1909.

[92] See *Tax Laws Amendment (Wine Producer Rebate and Other Measures) Act 2004* (Cth). Simultaneously, it introduced new rebates for wine producers under *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth).

[93] *Income Tax Assessment Act 1997* (Cth) Subdiv 40-F.

[94] *Income Tax Assessment Act 1997* (Cth) Subdiv 40-F.

[95] *Income Tax Assessment Act 1997* (Cth) Subdiv 40-G. From 1 July 2004, rural land irrigation water providers may be entitled to the concession: see *Income Tax Assessment Act 1997* (Cth) s 40-630.

[96] *Taxation Laws Amendment (Research and Development) Act 2001* (Cth) Sch 2 ss 11, 54, inserting ss 73BH and 73BA for 125% deductions calculated under Divs 43 and 40, respectively, of the *Income Tax Assessment Act 1936* (Cth).

[97] *Taxation Laws Amendment (Research and Development) Act 2001* (Cth) Sch 2 s 1, amending *Income Tax Assessment Act 1936* (Cth) s 73B(1).

[98] *Taxation Laws Amendment (Research and Development) Act 2001* (Cth) Sch 3 s 5, inserting *Income Tax Assessment Act 1936* (Cth) s 73I.

[99] *Taxation Laws Amendment (Research and Development) Act 2001* (Cth) Sch 3 s 5, inserting *Income Tax Assessment Act 1936* (Cth).

[100] *Income Tax Assessment Act 1922* (Cth) s 23(1)(e)(ii); *Income Tax Assessment Act 1936* (Cth) s 59.

the asset was converted from a depreciable asset to trading stock, in which case, any proceeds above cost might be characterised as ordinary income.[101] From 1985, proceeds above cost were a fully taxable capital gain, subject to indexation of the cost base.[102] If no changes had been made to the balancing charge rules, today capital gains on depreciable assets would be subject to vastly different rules for individuals and companies. However, none of the rationales for the partial exemption of capital gains for individuals applied to depreciable assets.

The RBT argued that it no longer made sense to divide gain obtained from disposing of a depreciated asset into excess depreciation recapture and capital gain components; it noted that, among other things, applying two sets of rules to different components of the gain added unnecessary complexity and compliance costs for businesses.[103] It suggested that the balancing adjustment be calculated as the difference between book value and proceeds of disposal, for both incorporated and unincorporated taxpayers.[104] This recommendation was accepted by the government. When it was enacted, the rule applied retrospectively from 21 September 1999,[105] the date the capital gains rules were changed to replace indexation with a 50% discount on individuals' capital gains and a 0% discount on corporate taxpayers.[106] Similarly, there was a rollover rule that allowed businesses to avoid excess depreciation recapture when disposing of an asset for more than its book value by using the recapture amount to reduce the cost of replacement assets. The RBT considered this rule complex and inequitable.[107] The government accepted the recommendation that the rollover be abolished and it ceased to apply from 21 September 1999.[108]

4. Black Hole Expenses

For almost eight and a half decades, the tests set out in the *Sun Newspapers Ltd v Commissioner of Taxation (Cth)* case[109] to distinguish revenue and capital expenses have guided the characterisation of business expenses in Australia. The tests distinguish expenses that are perceived to be connected with a business process, revenue expenses, and expenses perceived to be connected with a business structure (capital expenses), with only passing regard to the longevity of any benefit acquired as a consequence of an outgoing. One consequence of the application of this test was the creation of a large group of unrecognised expenses that became known as "black hole" expenses, so called because they were characterised as capital expenses but actually provided no long-term benefits to taxpayers and fell outside all existing depreciation rules, meaning they could never be recognised for income tax purposes. The RBT recommended legislative action to address the problem and the post-RBT reform legislation included a new five-year straight-line depreciation measure to ensure the expenses would be recognised when calculating taxable income.

B. The RBT and New Small Business Concessions

One of the most significant different recommendations of the RBT was adoption of a highly concessional tax regime for small business including a special generous depreciation system. The RBT stated that the small business sector comprising over 95% of businesses in Australia were bearing "almost 40% of the estimated $9 billion compliance costs incurred by Australian business".[110] The report suggested

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[101] See *Commissioner of Taxation (Cth) v Cyclone Scaffolding Pty Ltd* (1987) 18 FCR 183.

[102] *Income Tax Assessment Act 1936* (Cth) Pt IIIA.

[103] *RBT Final Report*, n 69, 320.

[104] *RBT Final Report*, n 69, 318.

[105] *New Business Tax System (Capital Allowances) Act 1999* (Cth) s 10, inserting *Income Tax Assessment Act 1997* (Cth) s 42-192.

[106] *New Business Tax System (Integrity and Other Measures) Act 1999* (Cth) s 13, inserting *Income Tax Assessment Act 1997* (Cth) s 115.

[107] *RBT Final Report*, n 69, 319.

[108] *New Business Tax System (Capital Allowances) Act 1999* (Cth) s 12, amending *Income Tax Assessment Act 1997* (Cth) s 42-285.

[109] *Sun Newspapers Ltd v Commissioner of Taxation (Cth)* (1938) 61 CLR 337.

[110] *RBT Final Report*, n 69, 31–32 [114].

that depreciation concessions could offset disproportionally higher costs to comply with tax obligations through increased cashflow of eligible small business entities.[111]

The small business depreciation provisions were included in a package of special rules for small businesses proposed by the RBT labelled the Simplified Tax System. They were one of a three element packages: a simplified trading stock valuation rule, the ability to use cash-basis accounting to recognise income and expenses, and a simplified depreciation regime based on a single small business pool for most depreciable assets.[112] Small businesses were defined as business taxpayers with an annual turnover (or average annual turnover for the current and previous two years) of less than $1 million, that owned depreciating assets valued at less than $3 million at the end of the year of income. The $1 million turnover threshold included the turnover of affiliates.[113] The RBT explained that the threshold would make the concessions available to over 95% of businesses (representing 850,000 businesses) in Australia.[114]

The RBT suggested the *simplified* depreciation rules provide an immediate write-off for each wasting asset costing less than $1,000 and for wasting assets costing $1,000 or more with an effective life not exceeding 25 years, a diminishing balance depreciation pool. Under these rules, the balance of the pool would be depreciated at the rate of 30%, with the cost of acquisitions added and the proceeds of disposals subtracted from the pool. In the event of proceeds greater than the balance of the pool, the excess would be reported as assessable income. The ordinary depreciation rules would continue to apply to assets costing $1000 or more with effective life periods of 25 years or more.

The logic of using accelerated depreciation as a subsidy to offset tax compliance costs was controversial at best. Studies have consistently confirmed that relatively, small businesses face higher regulatory compliance costs.[115] However, there is no clear answer as to whether a tax subsidy is the right tool to address this and if so, what type of tax subsidy would successfully reduce the compliance burden and level the playing field.[116] Nevertheless, after passing the GST legislation in 1999, the Howard Coalition Government resolved to move ahead in response to the RBT's proposals[117] and implemented the simplified depreciation rules in 2001.[118] They operated in lieu of Division 40 in which various depreciation rules were consolidated in that year.

Minor changes were made to the proposal at the implementation stage. The $1 million threshold for average turnover was calculated using any three of the previous four income years; more significantly,

[111] *RBT Final Report*, n 69, 581–584 (Recommendation 17.3: simplified depreciation regime for small business).

[112] *RBT Final Report*, n 69, 575. The policy background, including the RBT Report, which led to small business concessions being introduced, is well-illustrated in Michael Dirkis and Brett Bondfield, "The RBT ANTS Bite: Small Business the First Casualty" (2004) 19 *Australian Tax Forum* 107. See also Paul Kenny, "Legislative Design and Tax Reform: The Weakest Link?" (2010) 25(2) *Australian Tax Forum* 179; Glen Barton, "Reforming the Capital Allowances System" (1999) 34(5) *Taxation in Australia* 249.

[113] The meaning of "turnover" was set out in *Income Tax Assessment Act 1997* (Cth) s 328-375.

[114] *RBT Final Report*, n 69, 75.

[115] See Lignier and Evans, n 2; Lignier, Evans and Tran-Nam, n 2; Evans et al, n 2.

[116] Philip Lignier said the extent of the regressive tax compliance burden was inconclusive, especially because having to compile information for tax purposes also provided managerial benefits: Philip Lignier, "Measuring the Managerial Benefits of Tax Compliance: Fresh Approach" (2009) 24 *Australian Tax Forum* 117. Jeff Pope said the cash economy of small businesses counteracts the regressive tax compliance burden: Jeff Pope, "Favourable Small Business Taxation: To What Extent Is It Justified from a Tax Policy Perspective?" (2008) 1 *Journal of Applied Law and Policy* 21. The Australian Taxation Office has developed free online tools to help with business tax affairs. Increasing market competition is also likely to lead to more affordable pricing for tax and accounting software and professional services in the future.

[117] See Gordon Cooper, "The Government Response to the Ralph Report: An Initial Overview" (1999) 34(5) *Taxation in Australia* 232.

[118] *New Business Tax System (Simplified Tax System) Act 2001* (Cth) Sch 1 s 1, inserting *Income Tax Assessment Act 1997* (Cth) Subdivs 328-D, 328-F. While the RBT Report recommended that an active business test be applied to farmers occasionally leasing out plant and equipment, the simplified depreciation rule excluded horticultural plants, leased assets and software development expenditure from the pooling system, as they were pooled under a special regime. See also Robert Douglas, "The Simplified Tax System for Small Businesses – An Overview" (2000) 35(1) *Taxation in Australia* 28; Ian Crisp, "The New Business Tax System: Life After Ralph" (2000) 34(8) *Taxation in Australia* 411; Paul Kenny, "A 'Simplified Tax System' for Small Business" (2002) 6(1) *The Tax Specialist* 36.

only half the cost of assets acquired during the year was depreciable in the year of acquisition, with the other half added to the depreciation total the following year.[119] Taxpayers opting to use the simplified depreciation rules were required to pool assets with an effective life of 25 years or more and depreciate them at the rate of 5% on a diminishing value basis.[120] Also, primary producers were allowed to opt in to the pooling system, while using more favourable industry-specific depreciation rules on an asset-to-asset basis for assets left out of the pool.

IV. Post-RBT Changes to the Bifurcated Tax Depreciation System

The small business depreciation concessions adopted in response to the report of the RBT have not only remained in place since 2001, but have been enlarged and enhanced over the subsequent two decades. While the RBT offered a nominal rationale for the concessions, to offset regressive compliance costs, there is little evidence that the Coalition Government had any clear tax policy to deal with small business taxpayers at that time.[121] Contrary to the expectations of some, the election of a Labor Government in late 2007 led to an enhancement of the small business depreciation concessions as the new government sought to garner support for its proposed carbon emission trading scheme. The government's small business tax concessions passed through the Parliament but its carbon emissions scheme was voted down. After negotiating a compromise with the opposition leader Malcolm Turnbull who pledged his party's support for a revised carbon trading scheme, the government introduced the compromise Bill to Parliament but following the replacement of Malcolm Turnbull by Tony Abbott in late 2009, the opposition again voted against the scheme and the Labor Government had no choice but to abandon the proposal. The enhanced small business depreciation rules, described in detail below, nevertheless remained.

Following its election to power in 2013, the Abbott Coalition Government confirmed its continuing opposition to the adoption of a carbon emission trading scheme and, as explained further below, briefly wound back some of the small business depreciation concessions that had already been widened by the previous government as part of its package to introduce a trading scheme. Abbott's successor as Coalition leader and Prime Minister following a change in leadership of the Liberal Party in 2015, Malcolm Turnbull, and his successor who became leader in 2018, Scott Morrison, returned to the reverted to previous policy of support for the small business sector through depreciation concessions and progressively expanded the concessions. There have been no signs that the Labor Government elected in 2022 will move to reduce any of the concessions in place. A bifurcated tax depreciation system has become a structural feature of the Australian depreciation system.

A. The Productivity Commission and Widening the Small Business Tax Concessions

The accelerated depreciation options provided as part of the concessional small business regime adopted in response to the RBT provided significant benefits only to capital-intensive businesses. Unsurprisingly perhaps, uptake of the new rules was very low with only slightly more than one in four eligible businesses signing up for the depreciation concessions.[122] Many observers considered the initiative a failure.[123]

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[119] The actual mechanism used to accomplish this was slightly more complex, with a separate half depreciation for newly acquired assets added to the full depreciation of the pool value at the end of the previous year. In contrast, the RBT recommended that a new asset acquired during the year of income be accounted for depending on the quarter in which the asset was acquired (eg, 100% of the cost in the first quarter, 75% in the second quarter, 50% in the third quarter and 25% in the fourth quarter): *RBT Final Report*, n 69, 582.

[120] If a new asset was acquired during the year of income, a deduction was allowed in the amount of 15% cost for an effective life up to 25 years or 2.5% for an effective life of 25 years or more. It was implemented in quite a different manner from the approach suggested in the report, treating assets as if they were acquired in the third quarter of the year of income (see *RBT Final Report*, n 69, 582).

[121] Mark Pizzacalla, "Global SME Tax Policy Conundrum" (2008) 23(1) *Australian Tax Forum* 49.

[122] See discussion of the 2006 Senate estimates hearing in Commonwealth, *Parliamentary Debates*, House of Representatives, 24 May 2007, 51.

[123] See, eg, Michael Dirkis and Brett Bondfield, "Much Ado about Nothing: Ralph's Consideration of Small Business" (2005) 1(2) *Journal of the Australasian Tax Teachers Association* 110.

In October 2005, the government once again appointed an ad hoc taskforce to report on possible options for reducing regulatory costs for businesses, this time chaired by the head of the Productivity Commission. In January 2006, four months after its appointment, the taskforce submitted a report including several recommendations for changes to tax legislation.[124] The central recommendation was that the different definitions of "small business" found in the different tax laws providing concessions to the sector should be harmonised.[125] During its Budget Speech in the following month, the government endorsed the taskforce's recommendation to harmonise the definition of "small business".[126]

The following month saw yet another amendment of a structural importance which concerned taxpayers wishing to use the declining balance method of depreciation. The factor used to work out a declining balance depreciation rate had remained unchanged since 1955, when the government adopted the recommendations of the Hulme Committee, a body appointed to evaluated Australia's depreciation system.[127] The Committee suggested the declining balance calculation should be based on 150% of the straight-line depreciation rate (ie, 100% divided by the effective life), which it said produced a book value equivalent to what it would otherwise have been when applying straight line depreciation when two-thirds of an asset's expected lifetime had expired. This was the point at which, the Committee suggested, the asset would start requiring significant repair costs or would need to be replaced.[128] The conversion factor was enhanced in 2006 by an increase in the conversion factor to 200% of the straight-line depreciation rate for assets acquired after 9 May 2006.[129] The government explicitly recognised the change as concessional in nature, including the lost revenue in its tax expenditure accounts.[130]

In mid-2007, the government finally took steps to ensure the definition of "small business" was consistent for determining eligibility for income tax, GST and fringe benefits tax concessions.[131] The new definition increased the annual turnover threshold for the small business depreciation concessions from $1 million to $2 million (which, according to a report by the Board of Taxation the following year, covered 93% of all businesses in Australia[132]). The definition also removed the requirement for small businesses to hold depreciating assets valued at less than $3 million to be eligible for the depreciation concessions. Significantly, at the same time, while the turnover threshold was doubled, the method for calculating turnover changed. Instead of measuring turnover based on the value of business supplies, it included only the *ordinary income* of the business, as characterised by the courts. Gains other than ordinary income, such as capital gains, were no longer considered when evaluating whether a business qualified for the small business concessions regime.

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[124] Commonwealth Regulation Taskforce, *Rethinking Regulation: Report of the Taskforce into Reducing Regulatory Burdens on Business* (Report, January 2006).

[125] Commonwealth Regulation Taskforce, n 124, 121–122.

[126] Peter Costello, Treasurer, "Budget Speech 2006–07: Second Reading on the Appropriation Bill (No 1)" (Budget Speech, 9 May 2006) 5–6; affirmed in Australian Government, *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business: Australian Government's Response* (Report, August 2006) 63.

[127] Commonwealth Committee on Rates of Depreciation, *Report of the Commonwealth Committee on Rates and Depreciation* (Report, 1955) [22]–[29].

[128] Commonwealth Committee on Rates of Depreciation, n 127, [22]–[29].

[129] *Tax Law Amendment (Personal Tax Reduction and Improved Depreciation Arrangements) Act 2006* (Cth) Sch 5 cl 1, inserting s 40-72 into the *Income Tax Assessment Act 1997* (Cth). The amendment included an anti-avoidance measure to prevent taxpayers from splitting assets acquired prior to the application date to take advantage of the new depreciation formula for part of the remaining value of the asset: see Sch 5 cl 3.

[130] It is coded "B80 Simplified Depreciation Rules" in the Treasury, *Tax Benchmarks and Variations Statement 2019* (Australian Government, 31 January 2020) 81 <https://treasury.gov.au/publication/p2020-51153>.

[131] *Tax Laws Amendment (Small Business) Act 2007* (Cth) Sch 1 s 1, inserting s 328-110 into the *Income Tax Assessment Act 1997* (Cth).

[132] Commonwealth Board of Taxation, *Scoping Study of Small Business Tax Compliance Costs: A Report to the Treasurer* (Report, December 2007) 3.

Some commentators suggested that adjusting the eligibility requirements and other minor changes did little to address the complexity inherent in the so-called simplified system.[133] It appears that the decision to double the eligibility threshold and exclude certain income from the calculation was made without fully investigating the reasons why the previous version of the regime had such a low uptake rate.[134] For example, some eligible businesses, such as start-ups, would incur high compliance costs but derive little benefit from the accelerated depreciation rules.[135]

B. The Henry Review and Further Expansion of the Small Business Tax Concessions: 2009

At the end of 2007, the Coalition Government that had enacted and overseen the small business depreciation system lost its re-election bid. The following year, in its first Budget Speech, the newly elected Labor Government announced it would conduct a "root and branch" review of Australia's tax system to guide future tax initiatives. The review panel (known as the Henry Review) was headed by the Secretary of the Treasury, Ken Henry, and included representatives of other government ministries and academics. The Henry Review's final report, released in 2009, recommended increasing the turnover threshold for small business concessions to $5 million, while raising the immediate write-off threshold tenfold to $10,000 and incorporating the separate pool for assets with a life of 25 years or more into the generous 30% declining balance pool.[136]

The Henry Review explained its proposals as a means to offset the disproportionally high tax compliance burden faced by smaller businesses.[137] However, the benefits of the concessions would have favoured capital-intensive small businesses, including farmers, over other types of businesses that faced high compliance costs, particularly businesses with large numbers of employees, which relied primarily on labour inputs.[138] This was ironic give the Henry Review's focus on increasing productivity and encouraging entrepreneurial activity as important drivers for economic growth.[139]

In May 2009, seven months before the Henry Review's final report was released, a new investment allowance was made available to small businesses for new investment of $1,000 or more, and all other businesses, for new investment of $10,000.[140] The allowance included two additional concessions. The first was an additional deduction of 30% of the cost of an asset acquired between 13 December 2008 and 30 June 2009, if the asset was used by 30 June 2010. The second was at a lower rate, 10% of the cost of an asset acquired by 31 December 2010 and used by the end of the next year. The 30% investment allowance was available only if a taxpayer could commit to acquiring the relevant asset less than two months from when the law was enacted.

[133] Hodgson stated that the new definition did not improve the overall system: Helen Hodgson, "Small Business Simplification – Yet Again?" (2007) 11(2) *The Tax Specialist* 132. The change also created the added burden of dual bookkeeping and the need to keep abreast of tax law changes: see Margaret McKerchar, "The Impact of Income Tax Complexity on Practitioners in Australia" (2005) 20 *Australian Tax Forum* 529; Margaret McKerchar, "Is The Simplified Tax System Simple?" (2007) 10(3) *The Tax Specialist* 139; Paul Kenny, "Small Business Capital Allowances" (2018) 5(4) *Australian Tax Law Bulletin* 47.

[134] The 2006 Senate estimates hearing reported an initial uptake rate of approximately 28% of eligible businesses; mentioned in Commonwealth, *Parliamentary Debates*, House of Representatives, 24 May 2007, 51.

[135] Mark Pizzacalla, "Australia's SME Tax Identity Crisis" (2007) 22(1) *Australian Tax Forum* 19.

[136] The Treasury, *Australia's Future Tax System: Report to the Treasurer: Part One Overview* (Commonwealth of Australia, 23 December 2009) 87 (*Australia's Future Tax System Part One*). See also The Treasury, *Australia's Future Tax System: Report to the Treasurer*: *Part Two Detailed Analysis* (Commonwealth of Australia, 23 December 2009).

[137] *Australia's Future Tax System Part One*, n 136, 41.

[138] Fiona Martin, "STS Implications: How the 'Simplified Tax System' Will Affect Depreciation and Is It Worth It?" (2001) 36(5) *Taxation in Australia* 245; Kenny, n 112, 207–208.

[139] However, it suggested extension of immediate deductions for assets costing less than $1,000: *Australia's Future Tax System Part One*, n 136, 40–41. In contrast, Freebairn said the depreciation system provided a fairly neutral playing field for investment options across different industries: John Freebairn, "A Package of Less Special Deductions and Exemptions and Low Tax Rates" (2007) 22 *Australian Tax Forum* 65.

[140] *Tax Laws Amendment (Small Business and General Business Tax Break) Act 2009* (Cth) Sch 1 s 4, inserting Div 41 into the *Income Tax Assessment Act 1997* (Cth).

The R&D system was also simplified and streamlined. All special deduction rules for R&D expenditure incurred from 1 July 2010 onwards were converted into a tax credit system administered jointly by the Australian Taxation Office and the Commonwealth Department of Industry, Innovation and Science.[141]

The Henry Review's recommendations were adopted in part after several years. The government rejected the Henry Review's proposal to increase the eligibility threshold for small business concessions to $5 million annual turnover but in 2012, the threshold for immediate write-offs for asset acquisition costs was raised to $6,500 and, as the Henry Review had recommended, the separate pool for long-life assets was consolidated with the 30% declining balance pool.[142] In addition, businesses were provided with a special first year deduction rule for motor vehicles that were not immediately deductible. An immediate write-off was allowed when the business portion of the book value was $5,000 or less in the first year and if the value was greater than $5,000, a deduction of $5,000 plus 15% of the value.[143] The value remaining after the first year's deduction formed part of the small business pool in the second year. Arguably, the Labor Government established its carbon emissions trading scheme, using the tax depreciation system as an economic policy platform.[144]

C. The Abbott Government Retreat and Turnbull Government Expansion of Small Business Depreciation Concessions

In 2014, a year after it was elected to power, the Coalition Government led by Prime Minister Tony Abbott reversed some of the small business concessions the previous Labor Government had adopted in 2012. The immediate write-off threshold was scaled back from $6,500 to $1,000 and the special motor vehicle write-off was repealed.[145] The $2 million turnover threshold for small businesses remained in place. In a 2014 report, the Board of Taxation recommended the threshold be increased to $3 million, arguing this increase would help offset the effects of inflation.[146] However, the Coalition Government was not convinced of the need for broadening the concession and the threshold remained at $2 million.

The suspension of the new depreciation concessions was short-lived. In 2015, the Coalition Government changed direction and resumed extending concessions to small business with an immediate deduction for the cost of acquiring depreciating assets with a cost less than $20,000 acquired after 12 May 2015 and first used or installed and ready to use before 1 July 2017.[147] The concession was explained as a polity to improve small business cash flow, cut red tape and encourage growth of the sector.[148]

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[141] *Tax Laws Amendment (Research and Development) Act 2011* (Cth); *Income Tax Rates Amendment (Research and Development) Act 2011* (Cth).

[142] The threshold was raised to $5,000 and contingent on royal assent for the *Clean Energy Bill 2011* (Cth), increased further to $6,500. The *Tax Laws Amendment (Stronger, Fairer, Simpler and Other Measures) Act 2012* (Cth) included the former in Sch 2 Pt 1, replacing $1,000 with $5,000 in Subdiv 328-D of the *Income Tax Assessment Act 1997* (Cth) (*1997 Act*) and the latter in Sch 2 Pt 2, replacing $5,000 with $6,500 in the same Subdiv of the *1997 Act*.

[143] *Tax Laws Amendment (Stronger, Fairer, Simpler and Other Measures) Act 2012* (Cth) Sch 3 s 3, inserting s 328-237 into the *Income Tax Assessment Act 1997* (Cth).

[144] The climate policy fed political instability with several leadership spills between 2007 and 2015. See Carol Johnson, John Wanna and Hsu-Ann Lee, *Abbott's Gambit: The 2013 Australian Federal Election* (ANU Press, 2015); Ian Bailey et al, "The Fall (and Rise) of Carbon Pricing in Australia: A Political Strategy Analysis of the Carbon Pollution Reduction Scheme" (2012) 21(5) *Environmental Politics* 691.

[145] *Minerals Resource Rent Tax Repeal and Other Measures 2014* (Cth) Sch 3, replacing $6,500 with $1,000 in Subdiv 438-D of the *Income Tax Assessment Act 1997* (Cth) Sch 4 s 4, repealing s 328-237 of the *Income Tax Assessment Act 1997* (Cth).

[146] Commonwealth Board of Taxation, *Review of Tax Impediments Facing Small Business: A Report to the Government* (Report, August 2014) 40–43.

[147] *Tax Laws Amendment (Small Business Measures No. 2) Act 2015* (Cth) Sch 1 ss 2–3, inserting "Notes" into s 328-180 of the *Income Tax Assessment Act 1997* (Cth) Sch 1 s 9, providing the temporary threshold in s 328-18 of the *Income Tax (Transitional Provisions) Act 1997* (Cth). This concession provided significant cash flow benefits to eligible small businesses making relatively small acquisitions, but it did not benefit businesses wishing to acquire larger, more expensive assets that would help them grow their businesses. See also Paul Kenny, "Yet Another Round of Problematic Small Business Tax Concessions" (2015) 2(5) *Australian Tax Law Bulletin* 87.

[148] Australian Government, *Budget 2015: Growing Jobs and Small Business* (Commonwealth of Australia, 2015) 11 (*Budget 2015*).

At the same time, the government introduced a three-year depreciation concession for plant and structural improvements used for storing fodder and outright deductions for building or modifying fences used in a primary production business.[149] Sales of these assets were deemed to take place at the notional book value, safeguarding the concession against double deductions for construction expenditure.[150] Three years later, it replaced the three-year depreciation rule for fodder storage with an outright deduction[151] to further assist in farm investments.[152]

Following a change of leadership in 2015, the Coalition Government, under Prime Minister Malcolm Turnbull, considered ways to extend the small business tax concessions even further. Turnbull and the succeeding Prime Minister Scott Morrison of the Coalition have consistently emphasised on the importance of small business policies, quoting small businesses are the *engine room* of the economy where many big ideas begin and entrepreneurial opportunities reside.[153]

Under this "engine room" policy, in 2017, the government started reducing the small business corporate tax rate from 30% to 25% (initially 27.5%) and introducing new tax credits to return 16% (initially 8%) of small business net income back to the sector by 2023–2024.[154] In that year, the small business turnover threshold was significantly raised from $2 million to $10 million[155] and the temporary immediate deduction concession for assets costing less than $20,000 was extended until 1 July 2018.[156] Before that expired, it was extended for a third time, until mid-2019,[157] and again to mid-2020.[158] In addition, in 2019, the immediate deduction amount was increased to $25,000 for assets first used or installed and ready to use between 29 January 2019 and 2 April 2019, and to $30,000 for assets first used or installed and ready to use between 2 April 2019 and 30 June 2020.[159] The enthusiastic response to these immediate deduction concessions led the government to extend the concession to non-small businesses with an annual turnover of less than $50 million ("medium-sized businesses"); depreciating assets costing less than $30,000, acquired between 2 April 2019 and 30 June 2020 became eligible for immediate deductions.[160] Depreciation deductions applied to assets costing $30,000 or more during the assets' effective life.

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[149] *Tax Laws Amendment (Small Business Measures No 2) Act 2015* (Cth) Sch 2 s 17, inserting *Income Tax Assessment Act 1997* (Cth) ss 40-548, 40-551. This measure was expected to assist small business farmers: see *Budget 2015*, n 148, 10.

[150] *Tax Laws Amendment (Small Business Measures No 2) Act 2015* (Cth) Sch 2 s 19, inserting *Income Tax Assessment Act 1997* (Cth) s 40-555(4)–(5).

[151] *Treasury Laws Amendment (Supporting Australian Farmers) Act 2018* (Cth) Sch 1 s 2, replacing s 40-548 of the *Income Tax Assessment Act 1997* (Cth).

[152] Explanatory Memorandum, *Treasury Laws Amendment (Supporting Australian Farmers) Bill 2018* (Cth) 3.

[153] Australian Government, *Budget 2016-17: Sticking to Our National Economic Plan* (Commonwealth of Australia, 2016) 5; Australian Government, *Budget 2016-17: Making our Tax System More Sustainable* (Commonwealth of Australia, 2016) 18; Australian Government, *Budget 2019-20: Lower Taxes* (Commonwealth of Australia, 2019) 2.

[154] Explanatory Memorandum, *Treasury Laws Amendment (Enterprise Tax Plan) Bill 2017* (Cth) 3–4.

[155] *Treasury Laws Amendment (Enterprise Tax Plan) Act 2017* (Cth) Sch 3 s 15-18, amending s 328-110 of the *Income Tax Assessment Act 1997* (Cth). Also, the small business depreciation pool was not available for second-hand assets used in a residential property (*Income Tax Assessment Act 1997* (Cth) s 328-175(9A)).

[156] *Treasury Laws Amendment (Accelerated Depreciation For Small Business Entities) Act 2017* (Cth), requiring that the asset must be first used or installed and ready to use before 1 July 2018.

[157] *Treasury Laws Amendment (Accelerated Depreciation For Small Business Entities) Act 2018* (Cth), requiring that the asset must be first used or installed and ready to use before 1 July 2019.

[158] *Treasury Laws Amendment (Increasing and Extending the Instant Asset Write-Off) Act 2019* (Cth), requiring that the asset must be first used or installed and ready to use before 1 July 2020.

[159] *Treasury Laws Amendment (Increasing and Extending the Instant Asset Write-Off) Act 2019* (Cth).

[160] *Treasury Laws Amendment (Increasing and Extending the Instant Asset Write-Off) Act 2019* (Cth) Sch 2 s 2, inserting *Income Tax Assessment Act 1997* (Cth) s 40-82.

D. Board of Taxation Recommendations

In December 2019, the Board of Taxation published a long-awaited report (originally due in October 2018) on small business tax concessions,[161] calling for an ongoing immediate asset write-off system and a single depreciation rate for pooling small business expenditure. The Board of Taxation's 2019 report recommended further changes to the small business depreciation rules to help achieve these goals.[162]

The Board of Taxation recommended, first, that the immediate deduction for assets costing less than $30,000 (which was set to expire on 1 January 2021 and reversion to the old $1,000 threshold) should remain a permanent feature of the tax laws, in addition to removing the requirement that small business must use a small business pool for depreciating assets that are not eligible for immediate deductions.[163] Second, it suggested replacing the first-year depreciation rate of 15%, which applied to pooled expenses, with the ordinary small business pool rate of 30%.[164] In making this recommendation, it appears the Board relied heavily on submissions it had received that argued the reduced rate discouraged businesses from acquiring high-cost assets. The Board also noted the tax-induced incentive for businesses to stay small to be eligible for concessions (ie, bunching). It considered tapered or shading-out concessions for businesses with aggregated turnover slightly above the small business threshold but refused to stand by it due to the concerns that a tapered system would significantly increase the level of complexity of the small business tax concessions.[165]

The Board of Taxation did not seriously consider the distortions that accelerated depreciation brought to the income tax system in Australia. Accelerated depreciation allows eligible taxpayers to have lower effective tax rates on capital. This tax measure is economically harmful, however. It breaches tax neutrality and potentially leads to the impairment of efficiency and productivity in the allocation of capital in the economy.[166] Also, the concern for "staying small" arose because of the bifurcated depreciation system that favours small (and increasingly medium) businesses. A coherent depreciation system based on effective life would be economically logical while keeping the income tax system simpler.

E. Temporary COVID-19 Measures

The national health crisis that developed in early 2020 led to the introduction of some of the most significant assistance programs in Australian history. These initiatives were designed to reduce the effects of the economic downturn resulting from shutdown measures implemented during the COVID-19 pandemic. The subsidies included instant or accelerated depreciation measures to boost investment and facilitate the creation of more jobs.[167] Most of these took effect from 12 March 2020, the date the government first announced its economic response to the crisis.[168] The extension of the instant

[161] Commonwealth Board of Taxation, *Review of Small Business Tax Concessions: A Report to the Treasurer* (Report, March 2019) (*Review of Small Business Tax Concessions*).

[162] Specifically, the Board of Taxation claimed the relationship between depreciation concessions and increased investments was supported by empirical evidence: ibid 94, referring to David Rodgers and Jonathan Hambur, *The GFC Investment Tax Break* (Reserve Bank of Australia, 2018).

[163] *Review of Small Business Tax Concessions*, n 161, 93–95.

[164] *Review of Small Business Tax Concessions*, n 161, 93–94.

[165] *Review of Small Business Tax Concessions*, n 161, 53–54. The drawbacks of small business asset depreciation were discussed in Mark Burton, "The Australian Small Business Tax Concessions – Public Choice, Public Interest or Public Folly?" (2006) 21 *Australian Tax Forum* 71.

[166] The Canadian Government introduced temporary accelerated depreciation regime in 2018 with the stated intent of the policy to improve tax competitiveness and support business investment. Bazel and Mintz argue that accelerated depreciation is economically harmful. See Philip Bazel and Jack Mintz, "Policy Forum: Is Accelerated Depreciation Good or Misguided Tax Policy?" (2019) 67(1) *Canadian Tax Journal* 41.

[167] See, eg, Explanatory Memorandum, *Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Bill 2020* (Cth) [8.3]–[8.4]. According to this, the concessions were estimated to help 3.5 million businesses, comprising of over 99% of businesses in Australia ([8.6]).

[168] *Coronavirus Economic Response Package Omnibus Act 2020* (Cth).

write-off and accelerated depreciation rules under this program[169] raises uncertainty about how the future depreciation system will take place.

The COVID-19 measures were implemented as follows. First, small businesses (ie, earning less than $10 million) were allowed to write off assets costing less than $150,000, acquired on or after 12 March and before 1 July 2020.[170] The first-year depreciation rate for small business pools was also increased from 15.0% to 57.5%, which were available to assets ineligible for immediate deductions and first held on or after 12 March 2020 and first used or installed ready for use by 30 June 2021.[171] Both measures was extended to 31 December 2020; then, businesses must immediately deduct the cost of all assets acquired and first used or installed ready for use between 6 October 2020 and 30 June 2022.[172]

Second, medium-sized businesses (ie, earning at least $10 million and less than $50 million) were also allowed to write off assets costing less than $150,000, acquired on or after 12 March and before 1 July 2020,[173] which was extended for six months before expiry and then to all assets first held and used or installed ready for use between 6 October 2020 and 30 June 2022. Assets that were not subject to the instant write-off was deductible in the amount of 50% of the cost, given that they were first held on or after 12 March 2020 and first used or installed and ready to use by 30 June 2021 for principal use or location in Australia. The remaining cost was depreciable using the straight line or declining balance method, until the instant write-off rule carried over the depreciation from 6 October 2020.[174]

Third, the aforementioned concessions for medium-sized businesses were available to businesses with a turnover less than $500 million.[175] Later, the instant write-off rule was made available to businesses with a turnover of $5 billion for assets acquired and first used or installed ready for use between 6 October 2020 and 30 June 2022. For this, the following conditions were added: an asset must be new, committed to be held, constructed or used on or after 6 October 2020 and cannot be a primary production asset subject to separate concessional treatment.[176]

Overall, the COVID-19 measures placed emphasis on yet again the use of depreciation concessions as a means to boost the economy, though unlimited to specific industries as were before the depreciation regimes were modernised through push-and-pull political compromises in the 1990s. Whereas generous small business concessions have reinforced the significance of the small business sector in the economy, their temporary extension to medium-sized and large businesses have led the depreciation system standing on the verge of cashflow or expenditure taxation. There is no indication that the concessions will be extended beyond mid-2022 and then, the Australian depreciation system will revert back to the bifurcated system with small business concessions more certainly to continue.

V. Concluding Remarks

Since 2001, Australian has operated a bifurcated depreciation system, one under the roof of the so-called "uniform capital allowance" regime, which applies to all tangible assets based on their effective life, and the other, which provides accelerated depreciation for qualifying small business taxpayers. The journey to a bifurcated depreciation system began with the government's shift from industry-specific tax expenditures in the late 1980s but it was not until the RBT that policy swung completely to the bifurcated system with a focus on assistance for small and, to some extent, medium-sized, businesses.

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[169] *Treasury Laws Amendment (2020 Measures No. 3) Act 2020* (Cth) (assented on 19 June 2020); *Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Act 2020* (Cth) (assented on 14 October 2020).

[170] *Income Tax (Transitional Provisions) Act 1997* (Cth) s 328-180.

[171] *Income Tax (Transitional Provisions) Act 1997* (Cth) Subdiv 40-BA. After the temporary COVID-19 immediate deduction rule ceased on 31 December 2020, assets costing less than $1,000 would be eligible for small business pooling.

[172] *Income Tax (Transitional Provisions) Act 1997* (Cth) Subdiv 40–BB.

[173] *Income Tax Assessment Act 1997* (Cth) s 40-82.

[174] *Income Tax (Transitional Provisions) Act 1997* (Cth) Subdiv 40-BA.

[175] *Income Tax (Transitional Provisions) Act 1997* (Cth) Subdiv 40-BA.

[176] *Income Tax (Transitional Provisions) Act 1997* (Cth) ss 40-120(3), 40-125.

The rationale for a bifurcated system offered by the RBT – to provide subsidies to small business as an offset for regressive compliance costs – is at best problematic, with the benefit limited to capital intensive enterprises with investments in wasting tangible assets. The tax expenditure subsidy to offset compliance costs is not the only rationale that has been put forward for small business concessions, however. Some have noted the role of small business in providing employment, especially in creating new jobs and rationalised tax subsidies for the sector on this basis. The reality, however, is that new jobs offered in the small business sector are often offset by job losses elsewhere in the sector. Moreover, employment in a sector that is more susceptible to fluctuating market conditions often tends to be less secure.[177] Another rationale for tax subsidies is the important role small business plays in providing training and business education to employees. It is not clear, however, that this education is the optimal work training in a world increasingly shifting to a digital and technological economy. A third rationale for tax subsidies is to offset what might be described as the market failure that prejudices small business in obtaining funding from large financial institutions that are geared to large enterprises. To the extent this problem does exist, however, it may be offset by the growing mastery by smaller financial institutions and lenders of small business risk analysis and willingness to lend into the sector.

Importantly, even if the rationales for subsidised support for the small business sector could be sustained, they do not offer logical rationales for the narrow focus of subsidies through a bifurcated depreciation regime. At the time it recommended a concessional depreciation regime for small business, RBT set out a strong and persuasive case for removal of depreciation concessions and adoption of effective life depreciation across the board to provide a level playing field for all enterprises and to remove distortions that undermined the efficient allocation of resources through unbridled market forces. The logic behind the RBT's general depreciation conclusions is sound and should apply equally to the small business sector. Subsidies that purport to apply to the entire sector but which in fact are of benefit only to a subset of small enterprises are both inefficient and unfair. It may well be the case that the legislature is unwilling to risk political backlash that reform might entail, but Australia's bifurcated depreciation regime is an unfortunate feature of Australia's income tax system.

[177] John Revesz and Ralph Lattimore, Commonwealth Industry Commission, *Small Business Employment: Industry Commission Staff Research Paper* (Research Report, August 1997).