National Innovation and Science Agenda – Intangible Asset Depreciation

Outline of chapter

1.1 Schedule # to this Exposure Draft Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to provide a choice to either self-assess the effective life of certain intangible depreciating assets or use the statutory effective life in working out the decline in value.

1.2 All legislative references in this explanatory memorandum are to the ITAA 1997 unless indicated otherwise.

Context of amendments

1.3 The current law mandates the effective life to be used for certain intangible depreciating assets in calculating their decline in value, which may not necessarily reflect the period of time that the assets provide economic benefits to the taxpayer.

1.4 On 7 December 2015, the Government announced a package of measures designed to incentivise and reward innovation as part of its National Innovation and Science Agenda. One of those measures is to allow taxpayers to self-assess the effective life of certain intangible depreciating assets.

1.5 This measure will better align the taxation treatment of those assets with the actual period of time that the assets provide economic benefits. It also aligns the treatment of intangible depreciating assets with that of tangible assets.

1.6 These amendments implement the measure to allow self-assessment of the effective life of certain intangible depreciating assets.

Summary of new law

1.7 The new law allows a taxpayer to choose between using the statutory effective life or self-assessing the effective life of intangible depreciating assets in the table in subsection 40-95(7). The intangible assets to which this choice applies are:

- a standard patent;
- an innovation patent;
- a petty patent;
- a registered design;
- a copyright (except copyright in film);
- a licence (except one relating to a copyright or in-house software);
- a licence relating to a copyright (except copyright in a film);
- an in-house software;
- a spectrum licence;
- a datacasting transmitter licence; and
- a telecommunications site access right.

1.8 The chosen effective life is then used in calculating the decline in value of the intangible asset.

1.9 The new law also allows the taxpayer to recalculate the effective life in later income years if the effective life the taxpayer has been using is no longer accurate because of changed circumstances relating to the nature of the asset's use.

1.10 Further, if the cost of the asset increases by at least 10 per cent in a later income year the taxpayer must recalculate the effective life of the asset.

1.11 The taxpayer must also recalculate the effective life of the asset for the income year that the taxpayer started to hold it, if:

- the taxpayer is using an effective life because of the associate or same user rule in subsection 40-95(4) or (5); and
- the asset's cost is increased after the taxpayer started to hold it in that year by at least 10 per cent.

Comparison of key features of new law and current law

New law	*Current law*
To calculate the decline in value of certain intangible depreciating assets, a holder of the asset has the choice to either self-assess the effective life or use the statutory effective life.	To calculate the decline in value of certain intangible depreciating assets, a holder of the asset must use the statutory effective life.
Unless the asset is copyright, licence relating to copyright or in-house software, a subsequent holder of certain intangible depreciating assets must use the remaining statutory effective life, if the holder chooses to use the statutory effective life.	Unless the asset is copyright, licence relating to copyright or in-house software, a subsequent holder of certain intangible depreciating assets must use the number of years remaining in the effective life of the former holders.
If a subsequent holder of certain intangible depreciating assets self-assesses the effective life of the asset, the holder is not able to adjust the prime cost method formula.	No equivalent.
If in a later income year, the effective life used for certain intangible depreciating assets is no longer accurate due to a change in circumstances relating to the nature of the use of the asset, a holder of the asset is able to recalculate the effective life.	A holder of the asset is not able to recalculate the effective life.
If the cost of the intangible depreciating asset increases by at least 10 per cent in a later income year, a holder of the asset must recalculate the effective life.	A holder of the asset is not able to recalculate the effective life.
A new holder must recalculate the effective life for the income year that they start to hold certain intangible depreciating assets, if the cost of the asset increases by at least 10 per cent and the asset: • is acquired from an associate; • continues to be used by the former user; or • has a new user who is an associate of the former user.	A holder of the asset is not able to recalculate the effective life.

Detailed explanation of new law

1.12 The amendments provide a taxpayer with the option to self-assess the effective life of certain intangible depreciating assets they hold, or apply the existing statutory effective life from the table in subsection 40-95(7). The chosen effective life is then used in calculating the decline in value of the intangible depreciating asset. ***[Schedule #, items 4 and 6, subsection 40-95(7) and paragraph 40-105(4)(a)]***

1.13 In self-assessing the effective life of the asset, the taxpayer must work out the effective life in accordance with section 40-105, which includes taking into account:

- how they expect to use the asset;
- the estimated period of time that the asset can be used by any entity to derive income at its start time (for taxable purpose, for producing exempt income and non-assessable non-exempt income or for the purpose of conducting research and development activities);
- the rate of wear and tear reasonably expected from the intended use assuming the asset will be maintained in reasonably good order and condition;
- the likelihood of the asset becoming obsolete; and
- the estimated time when the asset is scrapped or abandoned.

1.14 A depreciating asset starts to decline in value from its start time, which is generally when the taxpayer first uses the asset or has installed the asset ready for use for any purpose.

1.15 The taxpayer must make the choice of whether to self-assess the intangible depreciating asset's effective life or use the statutory effective life for the income year in which the asset's start time occurs. ***[Schedule #, item 5, subsection 40-95(7A)]***

1.16 The choice must be made by the day the taxpayer lodges its income tax return for the income year, unless a later time is allowed by the Commissioner of Taxation.

1.17 The choice applies to that income year and all later income years, except where a choice is made to recalculate the effective life under subsection 40-110(1) due to its circumstances of use having changed (see paragraph 1.21).

Associate and same user rules

1.18 Subsections 40-95(4) and (5) continue to oblige a taxpayer to use an effective life equal to effective life of the former holder that is yet to elapse at the time the new holder starts to hold the asset, if a depreciating asset:

- is acquired from an associate, who has deducted or could have deducted the decline in value of the asset;
- continues to be used by the same user; or
- has a new user who is an associate of the former user.

1.19 For intangible assets, this means that the new holder of the asset does not have the choice to self-assess the effective life of the asset or use the statutory effective life in the table in subsection 40-95(7). ***[Schedule #, item 5, subsection 40-95(7B)]***

Example 1.1

Amy acquired a standard patent on 1 July 2017 for $150,000. She self-assesses the effective life of the standard patent to be 15 years and works out the decline in value to be $10,000 per annum.

Amy deducts the decline in value of the standard patent for the 2017-18, 2018-19 and 2019-20 income years.

On 1 July 2020, Amy sells the standard patent for $130,000 to an associate, Michael.

Michael is not able to choose to self-assess the effective life or use the statutory effective life for the standard patent, because the associate rule in subsection 40-95(4) would apply to him. He must use the effective life Amy has been using that is yet to elapse at the time he started to hold the standard patent.

On 1 July 2020, there were 12 years yet to elapse on the effective life that Amy has been using, so Michael must use an effective life of 12 years for the standard patent in working out his decline in value.

1.20 A new holder must use the effective life applicable to the asset in the table in subsection 40-95(7), where the asset continues to be used by the former user or has a new user who is an associate of the former user and:

- the new holder does not know and cannot readily find out which effective life the former holder was using; or

- the former holder did not use an effective life.

[Schedule #, item 3, subsection 40-95(6A)]

Recalculation of effective life

1.21 Where there are changes, in a later income year, to the circumstances relating to the nature of the use of an intangible asset that is in the table in subsection 40-95(7) that the taxpayer start to hold after 1 July 2016, the effective life of the asset may be recalculated. This is only available where the change in use makes the effective life that is being used inaccurate. ***[Schedule #, item 9, subsection 40-110(5)]***

1.22 If the cost of the asset increases by at least 10 per cent in a later income year the taxpayer must recalculate the asset's effective life. ***[Schedule #, items 7 to 9, subparagraphs 40-110(2)(a)(iii) and (iv) and subsection 40-110(5)]***

1.23 The taxpayer must also recalculate the effective life of the asset for the income year that the taxpayer started to hold it, if:

- the taxpayer is using an effective life because of the associate or same user rule in subsection 40-95(4) or (5); and
- the asset's cost is increased after the taxpayer started to hold it in that year by at least 10 per cent.

[Schedule #, item 9, subsection 40-110(5)]

1.24 This treatment is consistent with the treatment of tangible depreciating assets.

1.25 A recalculation of the effective life of an intangible depreciating asset must be done using self-assessment under section 40-105 (see paragraph 1.13).

Consequential amendments

Adjustment to the prime cost method formula

1.26 If a holder of an intangible depreciating asset is not the first holder of the asset, subsections 40-75(5) and (6) provide that the new holder needs to adjust the prime cost method formula to take into account the number of years that all former holders have held the asset. This adjustment does not apply to copyright, a licence relating to copyright or in-house software.

1.27 That is, instead of using the statutory effective life in the table in subsection 40-95(7), a new holder uses the number of years remaining in that effective life as at the start of the income year in which the holder acquires the asset.

1.28 Subsection 40-75(5) is being amended to ensure that it only applies in situations where a holder chooses to use the statutory effective life in the table in subsection 40-95(7) rather than self-assessing the effective life of the asset. ***[Schedule #, items 1 and 2, paragraphs 40-75(5)(b) and (c)]***

Tax cost setting under the consolidation regime

1.29 When an entity joins or leaves a consolidated group, its assets become or cease to be the assets of the group. The tax cost of the asset of the head company or leaving entity is set at the asset's tax cost setting amount.

1.30 The meaning of *tax cost is set* in section 701-55 is being amended so that it continues to apply appropriately to intangible depreciating assets listed in the table in subsection 40-95(7). ***[Schedule #, items 10 to 12, paragraph 701-55(2)(d)]***

Application and transitional provisions

1.31 The new law applies to intangible depreciating assets, listed in the table in subsection 40-95(7), that an entity starts to hold on or after 1 July 2016. That is, the current law continues to apply to these intangible depreciating assets that an entity holds before 1 July 2016. ***[Schedule #, item 13]***