TREASURY LAWS AMENDMENT (MEASURES FOR CONSULTATION) BILL 2021: INTANGIBLE ASSET DEPRECIATION

EXPOSURE DRAFT EXPLANATORY MATERIALS

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

Abbreviation	***Definition***
ITAA 1997	*Income Tax Assessment Act 1997*

Chapter 1
Intangible asset depreciation

Outline of chapter

1.1 Schedule # to this Bill amends the ITAA 1997 to provide the choice to self-assess the effective life of certain intangible depreciating assets rather than using the statutory effective life in working out the decline in value.

Context of amendments

1.2 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.

1.3 In the 2021-22 Budget, the Government announced the Digital Economy Strategy, which outlines actions and policies the Government is taking to grow Australia's future as a modern and leading digital economy by 2030. The Strategy includes measures to empower businesses to grow investment in digital technologies, one of which is to allow taxpayers to self-assess the effective life of certain intangible depreciating assets.

1.4 The amendments to provide the choice to self-assess the effective life of certain intangible depreciating assets 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 those intangible depreciating assets with that of tangible assets.

Summary of new law

1.5 The new law allows a taxpayer to choose to self-assess the effective life of intangible depreciating assets listed in the table in subsection 40-95(7) rather than using the statutory effective life specified in the table. The choice can be made in relation to intangible assets the taxpayer starts to hold on or after 1 July 2023. The intangible assets to which this choice applies are:

- a standard patent;
- an innovation 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);
- in-house software;
- a spectrum licence; and
- a telecommunications site access right.

1.6 The effective life is used to calculate the decline in value of the intangible asset.

1.7 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.

1.8 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.

1.9 The taxpayer must also recalculate the effective life of the asset for the income year that the taxpayer starts 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 increases after the taxpayer starts 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 can choose to self-assess the effective life rather than 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 for the prime cost method formula, if the holder does	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

not choose to self-assess the effective life.	former holders for the prime cost method formula.
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

1.10 The amendments provide a taxpayer with the ability to choose to self-assess the effective life of certain intangible depreciating assets they hold on or after 1 July 2023, or apply the existing statutory effective life specified in the table in subsection 40-95(7). The effective life is then used in calculating the decline in value of the intangible depreciating asset. ***[Schedule #, items 8, 10 and 12, subsections 40-95(7), (7A) and (7B), and paragraph 40-105(4)(a)]***

1.11 Paragraph 40-105(4)(a) applies to assets that start to be held before, on, or after 1 July 2023 which have effective lives in accordance with the table in subsection 40-95(7) and the effective life is not being recalculated. However, it does not prevent a taxpayer from choosing to self-assess the effective life under subsections 40-95(7) and (7A) of an asset the taxpayer starts to hold on or after 1 July 2023.

1.12 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 a taxable purpose, for producing exempt income and non-assessable non-exempt income or for the purpose of conducting research and development activities);
- the term of the asset and any options available for extension or renewal of that term; and
- the estimated time when the asset is likely to be scrapped, or sold for no more than scrap value or abandoned.

[Schedule #, item 11, subsection 40-105(1C)]

1.13 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.

1.14 Where the holder of an intangible depreciating asset specified in the table in subsection 40-95(7) has exclusive rights to exploit that asset, the exercise of those rights may include preventing unauthorised use by another person.

1.15 If the taxpayer chooses to self-assess the intangible depreciating asset's effective life, the choice must be made for the income year in which the asset's start time occurs. ***[Schedule #, item 10, subsection 40-95(7A)]***

1.16 The choice must be made by the day the taxpayer lodges their 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, or where the taxpayer must recalculate the effective life (see paragraphs 1.21 to 1.25).

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 the 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 can deduct 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 These rules will apply consistently to intangible depreciating assets listed in the table in subsection 40-95(7) that a taxpayer starts to hold on or after 1 July 2023. Consequently, 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 10, subsection 40-95(7B)]***

Example 1.1

Amy acquired a standard patent on 1 July 2024 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 2024-25, 2025-26 and 2026-27 income years.

On 1 July 2027, Amy sells the standard patent for $120,000 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 starts to hold the standard patent.

On 1 July 2027, there are 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 However, the 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 #, items 6 and 7, subsections 40-95(6) and (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 starts to hold on or after 1 July 2023, 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 15, 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 13 to 15, 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 starts 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 increases after the taxpayer starts to hold it in that year by at least 10 per cent. ***[Schedule #, item 15, 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 that a taxpayer starts to hold on or after 1 July 2023 must be done under section 40-105 using self-assessment (see paragraph 1.12).

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 period 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), the new holder must use the period remaining in that effective life as at the time the holder starts to hold the asset.

1.28 Subsections 40-75(5) and (6) are being amended to ensure that the adjustment applies only in situations where the new holder uses the statutory effective life specified in the table in subsection 40-95(7). This is the case regardless of whether the former holder used the statutory effective life or self-assessed effective life. ***[Schedule #, items 1 to 5, subsections 40-75(5) and (6)]***

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 16 to 18, paragraph 701-55(2)(d)]***

Minor and technical amendments

1.31 The table in subsection 40-95(7) is amended to remove the table item for petty patents. The petty patent system was replaced with the innovation patent system in 2001. There are no longer any petty patents that the depreciation rules could apply to. ***[Schedule #, item 9, table item 3 in the table in subsections 40-95(7)]***

Application and transitional provisions

1.32 The new law applies to intangible depreciating assets, listed in the table in subsection 40-95(7), that a taxpayer starts to hold on or after 1 July 2023. That is, the current law continues to apply to the intangible depreciating assets that a taxpayer holds before 1 July 2023. ***[Schedule #, items 8, 12 and 15, subsection 40-95(7), paragraph 40-105(4)(a) and subsection 40-110(5)]***

1.33 In this regard, the new law is beneficial to affected taxpayers as it allows taxpayers to choose an effective life for an intangible depreciating asset that reflects the actual economic life of the asset, rather than using the statutory effective life.