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Simplified depreciation and the small business pool

The simplified depreciation rules are attractive for small businesses as they allow an immediate write-off for assets costing less than $20,000. In contrast, tax paying entities that do not qualify as a small business must use the general depreciation rules (also known as the uniform capital allowance rules), where assets costing more than $100 need to be depreciated over their effective life. (And just to clarify, a small business is defined for tax purposes as an entity with an aggregated annual turnover of less than $2million.)

Where a small business chooses to access the simplified depreciation rules, it is required under these rules to pool most depreciating assets and deduct at a rate of 30%. A rate of 15% applies to newly acquired assets in the first year regardless of when the asset was acquired during that year.

Note that you can't depreciate certain types of assets under these rules, including horticultural plants, capital works, and software. Also note that if a business has been using the general depreciation rules in previous years, you are not locked in and can choose instead to use the simplified depreciation rules, as long as you qualify as a small business. However after June 30, 2017, businesses that opt out of simplified depreciation will be required to wait five years before they can re-elect to use these rules.

General small business pool

Small businesses can allocate depreciating assets that cost more than the instant asset write-off threshold of $20,000 or more to their general small business pool to be depreciated at a rate of 15% in the year of allocation and 30% in other income years on a diminishing value basis, irrespective of the effective life of the asset.

Note however that the threshold was temporarily increased to $20,000 from May 2015 to June 30, 2017, and is planned to revert to its previous level of $1,000 after that time. This will have the effect of drawing out the period of depreciation. This year's federal budget may hold a pleasant surprise and retain the $20,000 instant write-off threshold, but time will tell. For now, assets costing $20,000 or more can be allocated to the general small business pool up to the end of the current financial year.

Even if the income producing purpose use of the assets determines the amount to be depreciated to be less than $20,000 (or $1,000 in the future), the asset must still be allocated to the single general small business pool. The taxable purpose is the proportional value of a depreciating asset used for a taxable purpose (that is, in earning assessable income). For example, if a business owner buys a new computer for $1,200 and uses it 80% for business purposes and 20% for personal use, the taxable purpose proportion will be $960 (80% of $1,200).

Assets held at the time of choosing the simplified depreciation rules

When a small business chooses to access the simplified depreciation rules, it must allocate the taxable purpose proportion of the "adjustable value" of assets held at the start of the income year to the relevant pool at the beginning of that year.

The adjustable value of an asset is generally its cost less any decline in value to the date of adopting simplified depreciation, regardless of whether the decline in value amounts were deductible for tax purposes. Depreciating assets used or installed ready for use prior to choosing to use the simplified depreciation rules qualify for a deduction at the full pool rate of 30%.

To sketch this out by way of example, say Craig is a small business owner who chose to apply the simplified depreciation rules from July 1, 2014, when the threshold was $1,000. He owns a specialised mainframe computer in his app development business. This was purchased for $30,000 in the 2013 year, and the decline in value to date amounts to $6,000.

Craig estimated that the asset would be used 90% of the time for the purpose of producing assessable income. This means the taxable purpose proportion of the computer's adjustable value was $21,600 (90% of [$30,000 – $6,000]). This amount was allocated to Craig's general small business pool at the beginning of that year and depreciated at a rate of 30%. The same approach is adopted for the $20,000 threshold period, but with different dollar amounts, to June 30 this year. As Craig's general pool will most likely have reduced to below the current threshold before it reverts to $1,000, he can write-off the lot next tax time.

Newly acquired assets

Depreciating assets that cost more than the threshold ($20,000, or $1,000 from July 1, should no change be made) that a small business first uses, or has installed ready for use, during an income year in which it adopts the simplified depreciation rules must be allocated to a small business pool at the end of the year. The small business will qualify for a deduction at half the pool's normal 30% rate in the first income year, irrespective of when during that first year the asset is first used or installed ready for use.

This reduced 15% rate does not apply to depreciating assets used or installed ready for use prior to choosing to use the simplified depreciation rules. The full pool deduction rate would apply in these circumstances.

Pool balance falls below instant asset write-off threshold

Broadly, if the value of a small business pool before subtracting the depreciation deduction for the year is less than $20,000 (or less than $1,000 from next financial year), the small business may claim the entire pool, so the closing balance becomes zero.

Note however that the pool balance to be written off is not the "closing pool balance"; instead, a special calculation applies in working out the balance.

In simple terms, the balance is:

- the opening pool balance
- plus the cost of any additions to the pool (adjusted for any private use)
- plus the cost of any modifications, and update to or moving of, existing assets in the pool (adjusted for any private use)
- less the consideration received from the disposal of any pool assets.

To use another example, say Luisa's Dog Washing is a mobile pet washing business and satisfies the conditions to use simplified depreciation. In the 2013-14 income year, Luisa's Dog Washing purchased a fitted out van for $20,000. The van was used 100% for a taxable purpose. The business did not have any other assets in its general small business pool.

In its 2013-14 income tax return, as the cost of the van was more than the then $1,000 threshold that applied for that income year, the business claimed a deduction for 15% of the cost ($3,000), with the remaining cost ($17,000) being deductible in later income years under the pooling rules.

The business did not make any further purchases during the 2014-15 income year and the balance of the pool at the end of that year remained at $17,000. In its 2014-15 income tax return, Luisa's Dog Washing claimed a deduction of $17,000 for the balance of the general small business pool, as the balance of the pool at the end of the year is below the $20,000 threshold that applied for that year.