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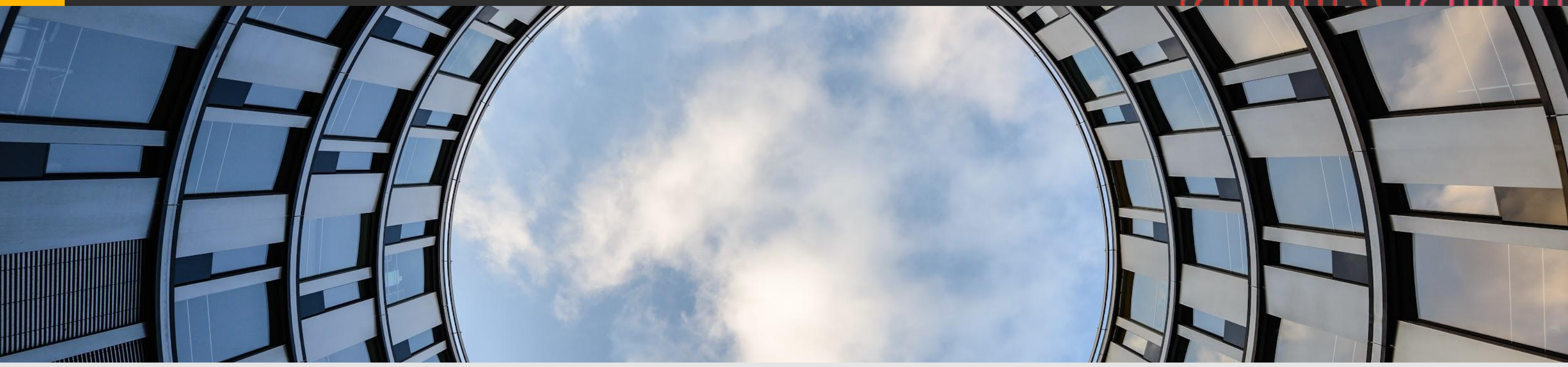
In Brief: Navigating the proposed removal of tax depreciation: Key considerations for businesses



At a glance

If the Government removes tax depreciation for commercial buildings, some of the considerations will be similar to those that arose in 2010 when tax depreciation was first removed. However ‘switching on’ tax depreciation in 2020 for a period then ‘switching it off’ again introduces additional complexities. In this publication we highlight key commercial, tax and financial reporting complexities businesses should be thinking about.

What’s the issue?

At the end of 2023, the Government announced its intention to remove tax depreciation on commercial buildings. The Government is expected to legislate this tax change in March 2024, with the intention that it will commence from the 2024/25 income tax year.

The ability to claim tax depreciation was removed in 2010 and reinstated in 2020 as part of the Government’s COVID-19 Stimulus Package. The impact of ‘switching on’ tax depreciation from 2020 and then ‘switching it off’ again for the 2024/2025 income year will introduce commercial, tax and financial reporting complexities.

In this publication we highlight key considerations business should be thinking about.

Tax considerations

Implementing these tax changes will require entities to carefully consider which buildings will be impacted by the law change.

Businesses will need to separate commercial building fit-out from the building structure in the tax fixed asset register, as fit-out should continue to be depreciable for tax purposes.

In addition, when in the process of purchasing a building, it will be important to ensure the purchase price allocation splits out the building and fit-out for tax purposes.

Changes to tax fixed asset registers may need to be considered.

Implementing the change from the 2024/2025 income year means early balance date taxpayers eg. income tax calculations/returns to 31 December 2024 will already be impacted.

Financial reporting considerations

The timing and the scale of the impact on deferred tax and tax expense will depend on a number of considerations.

Considerations for different reporting dates

The timing of when the tax law change is enacted or substantively enacted will have different implications for balance dates that precede or fall on that date, or follow that date. If the change is legislated before a reporting date, it must be accounted for in the financial statements. If the change is enacted after the reporting date, before the financial statements are authorised for issue, IAS 10 requires disclosure of these changes if they have a significant effect on current or deferred tax.

Therefore if the law change is legislated before, on, or shortly after 31 March 2024, businesses with a 31 March reporting date in particular will need to consider the impact of this change, and to what extent it will impact the FY24 and/or FY25 financial statements.

Which deferred tax balances will be impacted?

This tax change will impact accounting for deferred tax on buildings recognised on a *recovery through use basis* under IAS 12.

Deferred tax on buildings recognised on a *recovery through sale basis* under IAS 12 continues to be measured based on the expected tax consequences of sale and is therefore not impacted by this change.

Entities will therefore need to analyse existing fixed asset and tax registers to identify buildings where deferred tax is recognised on a *recovery through use basis.* This will include investment properties, where the rebuttable presumption that the carrying value will be recovered through sale has been rebutted.

The date a building was acquired will impact the accounting adjustment required

The deferred tax implication of this tax change will vary depending on whether a building was acquired before the 2010 law change, between 2010 and the 2020 law change, or subsequently and whether the initial recognition exception (IRE) was applied.

For example, the IRE would have been applied to buildings acquired on or after the 2010 law change became effective (which switched off tax depreciation). However this was not the case for buildings acquired prior to the 2010 law change.

IAS 12 does not contain clear guidance on how to deal with 'switching on' and 'switching off' situations where the IRE has been applied previously.

As a result, after the 2020 law change (which switched tax depreciation back on again), different interpretations and divergences in practice arose in relation to accounting for the change for buildings acquired on or after the 2010 law change became effective.

Therefore if the tax depreciation is switched off again in 2024, businesses will need to analyse and conclude on an appropriate accounting treatment for each 'bucket' of buildings depending on when these were acquired.

It is also likely that thinking around how to deal with the IRE will develop rapidly, so it is important for businesses to stay across these developments.

Other considerations

Apart from the tax and accounting impacts, the potential tax law change may have implications for commercial decisions that businesses need to assess, including:

- The cash impact of the potential tax law change;
- Impacts on key metrics;
- Implications for purchasing decisions;
- Potential revisions to terms or the price of impending purchases;
- Effects on banking covenants or thin capitalisation calculations affected by the increase in deferred tax liabilities; and
- The impact on continuous disclosure requirements for listed entities.

How we can help

If there is tax law change, there will also be tax and accounting consequences that you will need to be aware of depending on your situation.

Taking advantage of PwC's service offering can maximise opportunities for value to be gained.

If you need to discuss any of the above further, please contact your usual PwC advisor, who can introduce you to our team, or contact one of our team members below.

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