

CSUM 25/05: NZTCRA rejects argument that an interest amount paid under a relationship property agreement was deductible as an expense under the Income Tax Act 2007

Decision date: 17 April 2025

CASE

A v CIR [2025] NZTCRA 02

LEGISLATIVE REFERENCES

Income Tax Act 2007, ss DB 6, DA 1, and DA 2(2)

CASE LAW REFERENCES

Public Trustee v Commissioner of Taxes [1938] NZLR 436 (CA)

Williams v Commissioner of Inland Revenue (1988) 10 NZTC 5,078 (HC)

Fahey v MSD Speirs Ltd [1975] 1 NZLR 240 (PC)

Re Securitibank Ltd (No 2) [1978] 2 NZLR 136 (CA)

Colonial Mutual Life Assurance Society Ltd v Commissioner of Inland Revenue (2000) 19 NZTC 15,614 (CA)

Pacific Rendezvous Ltd v Commissioner of Inland Revenue [1986] 2 NZLR 567 (CA)

Eggers v Commissioner of Inland Revenue [1988] 2 NZLR 365 (CA)

Commissioner of Inland Revenue v Brierley [1990] 3 NZLR 303 (CA)

Reid v Commissioner of Inland Revenue (1990) 12 NZTC 7,153 (HC)

Commissioner of Inland Revenue v Haenga [1986] 1 NZLR 119 (CA)

Summary

Mr A sought to deduct interest expenses of \$18,069.31 in his 2016 income tax return. This amount related to interest Mr A was required to pay his ex-wife under a relationship property agreement. The Authority held there was an insufficient nexus between the interest payments and Mr A's assessable income and disallowed the deduction.

Impact

The decision adopts the well-established rules relating to determining a nexus between interest expenditure and derivation of income.

Facts

The facts were presented through an agreed statement of facts and oral evidence. Before, during, and after their marriage, Mr A had interests in several successful companies. On 5 April 2006, Mr A and Ms B entered into a relationship property agreement and a parenting plan agreement. Mr A was to keep his business interests and half of the proceeds from the sale of the family home. Ms B was to receive \$1.3 million from the sale of the family home towards her half share of the total settlement figure.

The family home was sold in April 2007. In July 2007 Ms B offered to forgo interest if Mr A paid the balance due in a lump sum before 30 September 2007. In the alternative Ms B would require penalty interest to be paid.

On 21 October 2015, Ms B received a High Court judgement that Mr A owed her \$210,355 and penalty interest of \$12,988.70. Ultimately, Mr A paid Ms B interest of \$249,249.23 and a capital payment on 5 November 2015. Mr A sought to adjust his tax position to take account of the interest paid. He justified the interest deduction on the basis he had effectively borrowed the funds and was required to pay interest to Ms B so as to avoid having to sell his income producing assets to pay Ms B or borrow money from a third party to retain his income earning assets.

In the Taxation and Charities Review Authority Mr A argued, through his tax agent, he incurred interest expenses arising from the relationship property agreement, there was sufficient nexus between the interest incurred and his income earning process, and he was therefore entitled to deduct these interest payments under DB 6 and DA 1(1) of the Income Tax Act 2007 (**ITA**).

The Commissioner's submission was the interest payments were not deductible under s DB 6 as they lacked the nexus and therefore did not meet general permission in s DA 1. Furthermore, the private limitation in s DA 2(2) would apply as they were private or domestic in nature.

Issues

Whether there was sufficient nexus between the interest payments and Mr A's income earning activities.

Decision

The Authority found that Mr A's relationship property obligations to Ms B arising from their settlement were without doubt distinct from his income earning activities. His income did not alter whether or not he paid Ms B, he derived no income from her and there was no business or income earning element in making the payments to her.

The reason for making the interest payments was deferral and default on Mr A's relationship property obligation; the obligation and the default had no direct, practical or necessary connection with Mr A's income earning activities. There was no underlying borrowing to which the interest payments related. His income was not affected by whether he paid the interest or not. As such there was not a sufficient nexus between the payments and Mr A earning income and the amount was not deductible.

The Authority looked at authorities dealing with borrowing for the purpose of asset retention first. The Authority distinguished the cases of *Public Trustee v Commissioner of Taxes*¹ and *Williams v CIR*² which were relied on by Mr A. In both cases, a taxpayer borrowed money and paid interest on that borrowing. These cases can be distinguished from the facts of the Mr A's case as Mr S did not pay money he owed, and interest obligations accrued due to not paying relationship property obligations as they fell due.

The Authority then turned to authorities regarding the nexus between expenditure and derivation of income, looking first at the character of the expenditure. The Authority identified comments from Richardson J in *Colonial Mutual Life Assurance Society Ltd v CIR*³ as material. This case held where interest was related to delay in making a payment of a particular character, the interest would be readily ascribed that same character.

¹ *Public Trustee v Commissioner of Taxes* [1938] NZLR 436 (CA).

² *Commissioner of Inland Revenue* (1988) 10 NZTC 5,078 (HC).

³ *Colonial Mutual Life Assurance Society Ltd v Commissioner of Inland Revenue* (2000) 19 NZTC 15,614 (CA).

Applying these principles, the Authority concluded the interest was related to Mr A's relationship property obligations and his failure to pay the money owed at the agreed times. There was no borrowing to which the interest related, and accordingly no capital funding could be related to retention of assets or have any nexus with Mr A's income earning companies.

The Authority then turned to interest deductibility under ss DB 6, DA 1 and DA 2(2) and reiterated there was no borrowing and therefore the principles that relate to deductibility of interest do not apply in this case. The Authority nevertheless highlighted the three principal authorities regarding the interest deductibility provisions relating to interest on borrowing. These are *Pacific Rendezvous Ltd v CIR*,⁴ *Eggers v CIR*,⁵ and *CIR v Brierley*.⁶ The Authority placed particular emphasis on the "use" test arising from *Pacific Rendezvous*. The Authority held that while the "use" test, as it relates to borrowing and interest paid on it, and the nexus with the application of the borrowed funds is not directly applicable (because as stated above there were no borrowed funds in this case) the principle of focusing on the nexus between the interest, the reason for paying the interest, and the character of the thing to which the interest relates, does apply. Applying this to the present facts, the relationship property obligation to which the interest relates was not concerned with Mr A's income earning activities. It was Mr A's default and delay in meeting his obligations – not his business interests – that caused Mr A's obligation to pay interest.

Applying ss DB 6 and DA 1 of the ITA, the Authority held the payments in contention do not come within the general permission, due to an absence of nexus with Mr A's income or income earning process.

The Authority finally considered the private limitation under s DA 2(2) of the ITA, although it was not the determinative issue. It found that as Mr A's circumstances failed to meet the general permission, there was no need to consider the private limitation further.

⁴ *Pacific Rendezvous Ltd v Commissioner of Inland Revenue* [1986] 2 NZLR 567 (CA).

⁵ *Eggers v Commissioner of Inland Revenue* (1988) 2 NZLR 365 (CA).

⁶ *Commissioner of Inland Revenue v Brierley* [1990] NZLR 303 (CA).