

CASE SUMMARY

Whether expenditure is of a capital or revenue nature is not to be found by any rigid test or description but upon consideration of all the circumstances; if capital in nature, it is not deductible for income tax purposes

Decision date: 02-December-2020

CASE

TRA 015/19 [2020] NZTRA 2

LEGISLATIVE REFERENCES

Income Tax Act 2007, ss DA1(1), DA2(1), DA2(7).

Tax Administration Act 1994, ss 3(1), 141(2), 141B, 141B(1), 141B(7), 141FB.

LEGAL TERMS

Repair and maintenance, capital in nature, non-deductible capital expenditure, shortfall penalty, unacceptable tax position.

Summary

The Tax Review Authority (the “**TRA**”) held that the Commissioner’s decision to disallow as repair and maintenance the sum of \$332,071.90 for the 2012, 2013 and 2014 income tax years pursuant to s DA2(1) of the ITA 2007, was correct.

The TRA disagreed with the Disputant’s assertion that the work undertaken on the Property and 6 Green Street were not related projects but were separate and independent of each other. The TRA agreed with the Commissioner that the Disputant was engaged in one overall project to undertake capital works on the Property and no portion of the disputed expenditure can be treated as deductible repair costs. The TRA also found that when viewed objectively, the Disputant’s 2012 tax position was about as likely as not to be correct and therefore the UTP shortfall penalty was correctly imposed.

Impact

The decision is an orthodox application of the law to the facts and reiterates the established legal principle that whether expenditure is of a capital or revenue nature is not to be found by any rigid test or description but upon consideration of all the circumstances.

Facts

The Disputant owns the Property and 6 Green Street; they are adjacent to each other. The Property contained a single story building and in October 2010 after the Disputant had taken vacant possession of the Property, the Disputant decided to undertake a programme of work on the Property. The work started in October 2010.

Various building consent applications which referenced both the Property and 6 Green Street were filed between October 2010 and January 2013. The proposed work included an internal refurbishment, the addition of a covered veranda/extension of a covered deck, additional toilets and the fitout of a container.

Issues

The broad issues for determination by the TRA were:

- Whether the expenditure disallowed by the Commissioner in the disputed tax years is of a capital nature and therefore subject to the capital limitation in s DA2(1) of the ITA 2007?
- As a sub-issue, whether there is one overall project or multiple distinct projects for the purposes of ascertaining whether any apportionment is available to the Disputant?
- Whether the Disputant is liable for the UTP shortfall penalty assessed by the Commissioner?

Decision

One overall project

The Commissioner considered that the physical object of the work done was the building on the Property both inside and outside and also 6 Green Street. The Disputant disagreed. The Disputant asserted that the object was the existing building on the Property only and did not include the outside works which extended onto 6 Green Street, claiming that these were “mutually exclusive”.

The TRA held that there was one overall project and dismissed the Disputant’s assertion that there was a ‘disjoint’ between the work being done to the Property due to its past use for rental purposes, and that done on 6 Green Street to increase the rental revenue.

Judge Sinclair concluded: “I do not accept that there is any such ‘disjoint’ in the work, or that it can be divided in the manner asserted by the disputant. The work done on the Property and on 6 Green Street could not “sensibly have been the subject of two independent, unrelated projects”. Rather it was a single project.... *TRA 015-19 [2020] NZTRA 2*

It was apparent from the existing and proposed plans that the works to the inside of the Property and extension onto 6 Green Street were planned at least by 27 October 2011 and that the physical object of the work was the existing building on the Property, including the external areas and amenities that extended onto 6 Green Street.

In reaching her conclusion, Judge Sinclair considered the following:

- The floor area of the building had increased from 250m² to 420m², necessarily including the area from 6 Green Street as the Property had a land area of 295m².
- The maximum occupancy load of the building had increased from 160 people to 247 people.
- The inability to obtain a Certificate of Public Use on the basis that the Council considered that the application related to the whole development, including the extension onto 6 Green Street.

- There was no separate functionality following completion of the work as the extension onto 6 Green Street became part of the building on the Property.
- The expenditure was not accounted for separately.

Expenditure subject to the capital limitation of s DA2(1) of the ITA 2007

The TRA held that “having found that the work was undertaken as one overall project, it follows that the cost of the total work cannot be apportioned into deductible revenue costs and capital costs. Rather, the total cost will either be capital or revenue in nature depending on the character of the project”. *TRA 015-19 [2020] NZTRA 2.*

The TRA concluded that the work undertaken constituted a substantial reconstruction and improvement of the original premises. *TRA 015-19 [2020] NZTRA 2.* Overall, the works extended and modernised the building and went beyond repairs and replacement.

Judge Sinclair found that the character of the project work was capital in nature and as a consequence, the character of the disputed expenditure is also capital in nature and is not deductible for income tax purposes.

Liability for the UTP shortfall penalty

The TRA held that the UTP shortfall penalty was correctly imposed. Existing case law at the time the Disputant took its 2012 tax position was clear that the total work was required to be taken into account in determining the nature of the disputed expenditure. The case law was also clear that the nature of work done as part of one overall project was to be taken from the character of the project work. *TRA 015-19 [2020] NZTRA 2.*

Judge Sinclair concluded: “I do not consider that it is a situation where the capital nature of the disputed expenditure was a matter on which reasonable minds could differ. I am satisfied...that the position taken by the disputant lacked any particular merit”. *TRA 015-19 [2020] NZTRA 2.*

Appeal Period

The Disputant has 30 days after the date of the decision to file an appeal.

About this document

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