Inland Revenue
Te Tari Taake

INTERPRETATION STATEMENT: IS 16/01

INCOME TAX – COMPUTER SOFTWARE ACQUIRED FOR USE IN A TAXPAYER'S BUSINESS

All legislative references are to the Income Tax Act 2007 unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this Interpretation Statement.

Contents

Scope of this statement

1. This statement covers the income tax treatment of software for taxpayers who purchase, lease, licence, develop, or commission software for use in a business carried on for the purposes of deriving assessable or excluded income. The statement expressly refers only to taxpayers that are carrying on a business. However, except where otherwise stated, the principles in this statement also apply to taxpayers who incur expenditure on software in deriving assessable or excluded income (otherwise than in the course of carrying on a business).

2. This statement does not consider:

- the income tax treatment of software for taxpayers that develop software for third parties – e.g to earn income from the sale or licence of the software (software developers);
- the treatment of software funded by a government grant and, in particular, the application of s DF 1; or
- the application of any specific research and development provisions other than s DB 34; or
- any potential withholding tax obligations that a taxpayer may have – for example, for royalties or interest paid to a non-resident software supplier, or for services provided by a non-resident contractor. These issues are covered in IG0007 "Non-resident software suppliers' payments derived from New Zealand – Income tax treatment" Tax Information Bulletin Vol 15, No 11 (November 2003) (it is noted that this statement is due to be reviewed).

Summary

3. The following is a brief summary of the main income tax implications of acquiring or developing software for use in a business. Further details are set out in the analysis section below.

Software purchases

- Software purchased will generally be a capital asset that must be depreciated at 50% diminishing value or 40% straight-line.
- An immediate write-off for software costing less than $500 will be allowed where the conditions in s EE 38 are satisfied.
- Maintenance costs may be deducted when incurred.
- Upgrade costs must be capitalised and depreciated.

Periodic payments for the right to use or access software

- Periodic payments for the right to use or access software (often online software) are generally deductible when incurred.

Software developed in-house for use in business

- Expenditure incurred in undertaking feasibility studies to determine whether to develop software will generally be deductible.
- Once a decision has been made to proceed with the development, any expenditure incurred beyond that point should be capitalised until the software is either completed or abandoned.
- If the software is completed for use in the taxpayer's business, the cost of the software can be depreciated at 50% diminishing value or 40% straight-line.
- If software is abandoned before it becomes depreciable property, a deduction may be allowed for the expenditure incurred in developing the software.

- Expenditure incurred in maintaining software once it has been completed will generally be deductible when incurred.

- Upgrade costs must be capitalised and depreciated.

Commissioned software

- Expenditure on software commissioned by a taxpayer for use in its business should be capitalised until the software is complete. The costs can then be depreciated over the life of the item.

- If the software is abandoned before it becomes depreciable property, a deduction may be allowed for the expenditure incurred in developing the software.

Lease of software under finance lease

- Software leased under a finance lease is treated as a sale of software by the lessor to the lessee. Also, the lessor is treated as giving a loan to the lessee for the software and the lessee is treated as using the loan to buy the software.

- The Act then applies to the arrangement as recharacterised.

- The financial arrangements rules apply to the loan.

- The depreciation rules apply as if the lessee owned the software.

- The treatment at the end of the finance lease depends on who acquires the rights to the software at the end of the lease term.

Introduction

4. In 1993, the Commissioner published a policy statement setting out the income tax treatment of computer software (see Appendix to *Tax Information Bulletin* Vol 4, No 10 (May 1993)). Since then, there have been a number of legislative changes that mean that parts of that item are now out of date.

5. This item updates and replaces the 1993 item except for the parts of that item that deal with taxpayers carrying on a software development business.

Analysis

6. This statement covers the income tax treatment of software for taxpayers who:

   - purchase software for use in their business;
   - make periodic payments for the right to use software (other than under a finance lease) in their business;
   - develop software in-house for use in their business;
   - commission software development for use in their business; or
   - lease software under a finance lease for use in their business.

7. Each of these situations is considered below. As the depreciation provisions are relevant to four of the situations, a more general discussion on depreciation is included after the discussion of the specific scenarios.

Software purchases

8. When software is purchased (whether "off the shelf" or online), generally the purchase price will be paid for the right to use the software (in the form of a licence). A taxpayer who acquires software for use in a business gets an enduring benefit. The expenditure incurred is capital in nature and non-deductible, but the taxpayer can claim depreciation on the software over its life.

9. The cost of maintaining the software is deductible expenditure under s DA 1. The cost of upgrades must be capitalised and depreciated. The depreciation treatment is discussed in more detail below (from [35]).

Periodic payments for the right to use or access software

10. Where a taxpayer makes periodic payments for the right to use or access software (other than software leased under a finance lease), the payments will generally not give rise to a capital asset. This can occur, for example, where a taxpayer pays a periodic licence fee for the right to use software or where a taxpayer pays a subscription fee to access software online (also known as software as a service). The payments will be deductible under s DA 1 (subject to the general limitations in s DA 2). A deduction will be allowed in the income year that the expenditure is incurred, unless a specific timing provision applies.

Software developed in-house for use in business

11. A business (not including a software development business) may develop software in-house for use in its own business. Developing software in-house will generally create a capital asset. The tax treatment of the costs incurred in the software development will differ for different phases of the development. More detailed principles relating to the deductibility of expenditure incurred in developing or acquiring a capital asset are set out in the interpretation statement IS 08/02: "Deductibility of Feasibility Expenditure" (*Tax Information Bulletin* Vol 20, No. 6 (July 2008): 12). However, in summary, the following principles apply.

Expenditure determining whether the software is feasible

12. Expenditure incurred in undertaking feasibility studies to determine whether to develop a capital asset will generally be deductible under s DA 1(1) (assuming the asset is to be used in the taxpayer's income earning process). In the context of software development, this means that expenditure incurred analysing the feasibility of developing a piece of software for use in a business would be deductible. That is, expenditure incurred principally for the purpose of placing a taxpayer in a position to make an informed decision about the development of some software will not generally be expenditure incurred in relation to that software.

Expenditure developing the software

13. Once a decision has been made to proceed with the development, any expenditure incurred beyond that point will relate to the software. From that point on, expenditure should be capitalised until the software is either completed or abandoned. This includes both direct costs and indirect costs. Direct costs include personnel costs directly attributable to the project, and depreciation costs on hardware dedicated to the project. Indirect costs are overhead costs that cannot be directly linked to a particular project. These may include general overhead costs (such as rates, rent, insurance, and energy costs), indirect labour costs, and indirect material costs (such as paper, and printer toner).

14. Direct costs should be relatively easy to calculate (for example personnel costs can be calculated by recording the direct hours spent by staff on a project).

15. Indirect costs (including utility costs, rental or ownership costs of property etc…) should be allocated using a method that gives a fair and reasonable result. A possible allocation method might be based on the proportion of direct person hours allocated to the project. Where accurate time recording is not undertaken, a functional analysis of what each employee working on the project does may be appropriate. However, a taxpayer can use another method if it can be shown that it is appropriate. For example, in some circumstances, a method based on the proportionate time and space used for the project may be appropriate.

16. If the software is completed for use in the taxpayer's business its cost can be depreciated (see from [35] below). To be depreciable, the software must be used or available for use. In the Commissioner's view, a piece of software will be available for use when it is capable of being used for the purpose that it was developed. This is likely to be after it has been tested to determine that it works as intended and when it is ready (or materially ready) to 'go live'.

17. For depreciation purposes, s EE 18B includes the amount of expenditure incurred in developing the software as part of the cost of the copyright in the software. The copyright in the software is the depreciable property, as it is listed in sch 14. If the software is developed as a series of modules that can be operated independently, each module can be depreciated as it is implemented. At that time it will be "depreciable property", and will be used or available for use in the taxpayer's business.

18. If the software is abandoned before there is an item of depreciable property, s DB 40B may allow a deduction (see from [28] below).

Research and development (R&D) expenditure

19. An alternative treatment may be available where the expenditure on software is "research" or "development" and is recognised as an expense for financial reporting purposes[1].

20. The main provision of the Act applicable to R&D expenditure is s DB 34. Section DB 34 allows a deduction for expenditure (other than expenditure excluded under s DB 34(6)) incurred on R&D by those persons who:

- recognise the R&D expenditure as an expense for financial reporting purposes under either of two designated financial reporting standards (s DB 34(2));
- recognise the R&D expenditure as an expense for financial reporting purposes because it is written off as an immaterial amount but, had it been material, would have been required to recognise it as an expense for financial reporting purposes under either of the two designated financial reporting standards (s DB 34(4)); or
- incur R&D expenditure of $10,000 or less in an income year, have recognised it as an expense for financial reporting purposes (but not, necessarily, under either of the designated reporting standards) and have written the amount off as immaterial (s DB 34(5)).

21. "Research" and "development" are both defined in paragraph 8 of the New Zealand Equivalent to International Accounting Standard 38, in effect under the Financial Reporting Act 2013, and as amended from time to time or an equivalent standard issued in its place.

22. Taxpayers who incur R&D expenditure (excluding interest) can claim the deduction in the income year the expenditure is incurred or they can choose to allocate the

[1] See *Tax Information Bulletin*, Vol 26, No 4 (May 2014) for a discussion of the relationship between the minimum financial reporting requirements for companies under the Tax Administration (Financial Statements) Order 2014 and the references to financial reporting standards in the Income Tax Act 2007.

expenditure to a later income year in accordance with s EJ 23. A deduction can only be made in a later income year if there is income that arises as a result of the R&D expenditure in that year (R&D income). A taxpayer who is eligible for a deduction under s DB 34 has the option of not taking the deduction. They have the option of returning their income and expenditure on the basis that the section does not apply (s DB 34(8)).

23. If applied, the R&D rules override the capital limitation but the general permission and other general limitations still apply (s DB 34(10)).

Post-development maintenance and upgrades

24. Expenditure incurred in maintaining software once it has been completed will generally be revenue in nature and deductible under s DA 1. This would include expenditure such as fixing programming bugs, providing help desk facilities and making minor changes to the software - that is, routine changes that do not materially increase the capacity or performance of the software.

25. Expenditure on upgrades (or improvements) to the software will be capital in nature. A change will be an upgrade when it adds new features to the software, or increases its capacity, performance or life. The cost of upgrades must be capitalised and depreciated.

Other post-development expenditure

26. The capital cost of an item includes any expenditure on installation and getting the item ready for using to earn income (see *BP Refinery (Kwinana) Ltd v FCT* (1960) 12 ATD 204 and IS 10/06 "Deductibility of business relocation costs" Tax Information Bulletin Vol 22, No 8 (September 2010)). Therefore, any expenditure on installing or integrating the software with the taxpayer's system will be capital.

27. Other post-development expenditure will usually be deductible under s DA 1. These costs could include, for example, producing instruction manuals and staff training.

Unsuccessful software

28. Section DB 40B overrides the capital limitation and provides a deduction for expenditure incurred on unsuccessful software development (to the extent that a deduction has not already been allowed). It only applies where the software was being developed for use in the taxpayer's business. The development of the software must be abandoned before the copyright in the software becomes "depreciable property". Section DB 40B also requires that the copyright in the software would have been depreciable property if the development had been completed.

29. If the requirements of s DB 40B are met, a deduction (for both the current year expenditure and the expenditure capitalised in earlier income years) is allowed in the income year in which the development of the software is abandoned.

Sale of copy of developed software

30. A taxpayer who has developed software for use in their business (and capitalised and depreciated the development costs) may also subsequently sell a copy to a third party. For example, a manufacturing business may sell a copy of the stock control software used in its business to another manufacturing business. The proceeds of the sale will be assessable income.

31. The taxpayer should continue to depreciate the development costs. If there are costs associated with producing the second copy of the software (for example, the costs of printing manuals and training materials), these will be deductible.

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Commissioned software

32. Commissioned software is treated the same as software developed in-house (see from [11] above). Software commissioned by taxpayers for use in their business will be a capital asset. The costs must be capitalised until the software is complete. The costs can then be depreciated over the life of the item. The depreciation treatment is discussed in more detail below (from [35]).

33. If the development is abandoned before the software is completed, s DB 40B may apply to allow a deduction for the costs incurred. See [28] and [29] above. The treatment of post-development expenditure is the same as for software developed in-house (see from [24] above).

34. Where the expenditure on the software is "research" or "development" expenditure, s DB 34 may apply to allow an earlier deduction. See from [19] above.

Depreciation

35. Under s EE 6, for property to be depreciable, it must be property that, in normal circumstances, might reasonably be expected to decline in value while it is used (or available for use) in a business. For intangible property to be depreciable, it must also be listed in sch 14. Schedule 14 includes the copyright in software, the right to use the copyright in software, and the right to use software (such as under a licence). The property must also not be subject to any of the exclusions in s EE 7 (for example, low value property that has been dealt with under s EE 38).

36. The depreciation rate for the copyright in software, the right to use the copyright in software, and the right to use software is 50% diminishing value or 40% straight-line. An immediate write-off for software costing less than $500 will be allowed where the conditions in s EE 38 are satisfied.

37. If a taxpayer has a number of low value items of depreciable property (each item being below the maximum pooling value in s EE 65 (generally $5,000)), the taxpayer may be able to use the pool method to depreciate the group of items. The requirements for using the pool method are set out in ss EE 20 to EE 24, EE 65 and EE 66.

38. The cost of software upgrades (improvements) must be capitalised and depreciated (at 50% diminishing value or 40% straight-line). Section EE 37 sets out how improvements should be depreciated. It provides for improvements to be treated as separate items of depreciable property from the item being improved.

39. If a taxpayer believes that their particular software should have a higher or lower rate than that set by the Commissioner, the taxpayer can apply to the Commissioner for a special rate under s 91AAG of the Tax Administration Act 1994. The requirements for an application, including the associated fees, are set out in the Income Tax (Depreciation Determination) Regulations 1993. For a special rate to be given, a taxpayer needs to demonstrate that the economic life of their software is either greater or less (as the case may be) than four years (which is the economic life on which the 50% diminishing value and 40% straight line rates are based). The consequences of obtaining a special rate are set out in s EE 36.

When software disposed of or no longer used

40. Sections EE 48 to EE 52 apply where a person receives consideration from the disposal of an item of depreciable property in the circumstances described in ss EE 44 to EE 47. They set out how to calculate an amount of depreciation recovery income or depreciation loss and may give rise to an amount of income or deduction. Relevantly, however, ss EE 48 to EE 52 do not apply when a person

disposes of an item of intangible property as part of an arrangement to replace it with an item of the same kind.

41. Section EE 39 applies when a person has an item of depreciable property (other than property that had been depreciated using the pool method) that is no longer used. Section EE 39(4) provides that a person will have an amount of depreciation loss if:

- they no longer use the item in their business, and
- neither they nor an associated person intends to use the item in deriving assessable income or carrying on a business for the purpose of deriving assessable income, and
- the costs of disposing of the item would be more than any consideration they could derive from disposing of it.

42. When the above criteria are met, a taxpayer will have an amount of depreciation loss equal to the item's adjusted tax value at the start of the income year. The taxpayer will be entitled to a deduction for this amount under s DA 1. The item's adjusted tax value at the end of the income year will then be zero.

43. Sometimes, taxpayers may not wish to or may not be able to dispose of their software when it is no longer useful. Also, sometimes, rather than being disposed of, old software may be incorporated into a new version. The Commissioner's view is that, where the software is still capable of being used by the taxpayer, it can continue to be depreciated. Where the software is incorporated into a new piece of software, the Commissioner's view is that the software is still used or available for use and can continue to be depreciated.

Lease of software under finance lease

Meaning of "finance lease"

44. "Finance lease" is defined in s YA 1:

> **finance lease** means a lease of a personal property lease asset entered into by a person on or after 20 May 1999 that—
>
> (a) when the person enters the lease, involves or is part of an arrangement that involves—
>
> (i) the transfer of the ownership of the asset to the lessee or an associate of the lessee during or at the end of the term of the lease:
>
> (ii) the lessee or an associate of the lessee having the option of acquiring the asset for an amount that is likely to be substantially lower than the asset's market value on the date of acquisition:
>
> (iii) a right of an associate of the lessee to acquire the asset, or a right of the lessor to require an associate of the lessee to acquire the asset, during the term of the lease under an arrangement that does not entitle the associate to receive all of the personal property lease payments that may fall due after the acquisition:
>
> (b) when the person enters the lease or from a later time, involves a term of the lease that is more than 75% of the asset's estimated useful life as defined in section EE 63 (Meaning of estimated useful life):
>
> (c) the person enters on or after 20 June 2007 and is, or is part of, an arrangement that, when the person enters the lease or when a change in the terms of the arrangement changes the allocation or size of the risks and rewards incidental to ownership of the lease asset,—
>
> (i) involves the use of the asset outside New Zealand for all or most of the term of the lease; and
>
> (ii) involves income of any person who is not the lessor, arising from the use of the asset by any person, that is exempt income, or excluded income, or non-residents' foreign sourced income; and

(iii) is a finance lease under NZIAS 17 for the lessor, or for a company that is in the same group of companies as the lessor and derives assessable income from the arrangement, or is an arrangement under which persons who do not include the lessor bear substantially all the risks and rewards incidental to ownership of the lease asset, determined as at the time the person enters the lease and taking into account later changes to the arrangement

45. The term "lease" is defined in s YA 1. Relevantly, for the purposes of the finance lease provisions, it treats two or more consecutive or successive leases of the same property (to the lessee or an associate) as a single lease.

46. Therefore, a lease will be a "finance lease" if it meets the criteria in one or more of paras (a), (b), or (c) of the definition.

47. Broadly, para (a) captures arrangements where ownership of the lease asset is transferred to a lessee (or an associate), or the lessee (or an associate) has an option to acquire the lease asset for substantially below market value. It also applies where the arrangement involves a right of an associate of the lessee to acquire the asset, or a right of the lessor to require an associate of the lessee to acquire the asset, during the term of the lease where the associate is not entitled to receive all of the lease payments after the acquisition.

48. Paragraph (b) applies where, either when the person enters the lease, or at a later date, the term of the lease is greater than 75% of the asset's estimated useful life.

49. Paragraph (c) will apply less commonly. In particular, it only applies where the leased asset is used outside New Zealand for all or most of the term of the lease, and involves exempt income, excluded income or non-residents' foreign sourced income arising from the use of the asset (other than by the lessor).

Implications of having a finance lease

50. When personal property is leased under a finance lease, the lease is treated as a sale of the lease asset by the lessor to the lessee on the date on which the term of the lease starts (s FA 6). Also, the lessor is treated as giving a loan to the lessee for the lease asset and the lessee is treated as using the loan to buy the lease asset. The Act then applies to the arrangement as recharacterised.

51. As the lease is recharacterised as a sale with an associated loan, the financial arrangements rules in subpart EW apply. For the lessor, the amount of the loan is determined under s EW 32 (s FA 7(1)). For the lessee, the amount of the loan is determined under ss EW 32 and EW 33 (s FA 7(2)).

52. The depreciation rules in subpart EE also apply. The lessee is treated as the owner of the software (s FA 8(2)) and the lessor is not treated as the owner of the software. The depreciation treatment is discussed in more detail above (from [35]).

53. Where an operating lease becomes a finance lease, the lessor and lessee must both adjust their income and expenditure. Section FA 11 sets out the requirements and formula for the adjustments.

Treatment when the lease ends

54. Section FA 9 sets out the treatment at the end of a finance lease where the lessee acquires the asset. When a lessee acquires the software by the end of the lease term, the acquisition is treated as the same sale that was previously treated as occurring under s FA 6. Where the lessee (or an associate) acquires the software and later disposes of it for more than the consideration they paid, the excess is income of the lessee under s CC 11 (unless it is income under another provision of the Act). The income must be returned in the income year in which the lessee (or associated person) disposes of the asset (s FA 9(3)(a)).

55. Section FA 10 sets out the treatment where the lessor is treated as acquiring the asset at the end of the lease (because the lessee has not acquired the lease asset by the end of the lease).

Examples

56. The following examples are included to assist in explaining the application of the law.

Example 1 – periodic payments for access to online software

57. United Chemists Ltd runs a chain of pharmacies. It uses online accounting software for financial reporting, invoicing, inventory management and payroll. United Chemists pays a subscription fee of $50 per month to access the software online. United Chemists wants to know whether this fee is deductible.

58. The fee is deductible under s DA 1.

Example 2 – unsuccessful software developed in-house for use in taxpayer's business

59. Sell To Me Ltd sells household goods online. It stores the goods in five large warehouses around New Zealand. In the 2014 income year Sell To Me Ltd decided to develop some new inventory management software. It employed a computer science student (Stanley) to undertake this work and purchased a computer that was used 50% by Stanley and 50% for other business purposes.

60. Stanley works on the software for three months during a holiday break from university. In total, Sell To Me Ltd incurred expenditure of $50,000 developing the software. This amount includes Stanley's wages, 50% of the depreciation on the computer for the relevant period, and rent and utilities for the office space leased for Stanley to work in. Stanley was never able to make the software function correctly. After three months, he left Sell To Me Ltd and returned to university. In the 2015 income year, Sell To Me Ltd discovers that it is going to cost a further $50,000 to complete the software. It decides to abandon development of the software and purchase an off the shelf inventory management system instead. Sell To Me Ltd wants to know how the software development costs should be treated for income tax purposes.

61. In the 2014 income year, a decision has already been made to proceed with the software development. Therefore, the expenditure incurred is capital and not deductible in the 2014 income year. The expenditure is also not depreciable in the 2014 income year as there is no completed asset available to be used in the taxpayer's business. In the 2015 income year, Sell To Me Ltd decides to abandon the software. It is entitled to a deduction for all of the expenditure incurred in the development of the unsuccessful software.

Example 3 – software commissioned for use in taxpayer's business

62. In the 2013 income year, Bank With Me Ltd contracts with XYZ Software Limited to design and implement a new app to allow its customers to undertake banking transactions from their smart phones. Bank With Me will receive all rights to the app once it is complete. The software is completed in the 2015 income year. After completion, XYZ runs a two day training course for Bank With Me's staff to teach them how to use the new software. XYZ also provides ongoing maintenance services once the app is running. Bank With Me wants to know how to treat the payments that it makes to XYZ for income tax purposes.

63. The development costs incurred by Bank With Me on the app software must be capitalised until the 2015 income year when the app software is completed. At

that time, it will be available for use in the taxpayer's business and the costs can be depreciated.

64. Once the app software is complete, any payments for maintenance services will be deductible when they are incurred.

65. The costs of training staff to use the app once it is complete are revenue in nature and are deductible when incurred.

Maintenance

66. A short time later, one of the major mobile phone software providers upgrades its operating system. Bank With Me's app will not run on the upgraded system so Bank With Me hires XYZ Software again to make the relatively minor modifications required so that the software will run on the new operating system. At the same time, XYZ Software also fixes a number of minor bugs. Bank With Me wants to know whether the costs of the changes should be treated as capital or revenue.

67. The changes to Bank With Me's app are revenue and can be deducted when incurred. As operating system software is upgraded relatively frequently, making modifications to software so that it can run on the upgraded system is more in the nature of maintenance rather than an upgrade. The changes do not add any new functionality as such. Rather they allow the app to continue to run consistently with its original specifications. The fact that a few minor bugs were fixed at the same time does not change this conclusion.

Upgrade

68. The following year, Bank With Me decides to make some modifications to the app to allow users to make payments directly to other app users via Bluetooth. Bank With Me again hires XYZ Software to make the changes.

69. The change adds a material new function to the software and, as such, is an upgrade and should be capitalised and depreciated in accordance with s EE 37.

Example 4 – allocation of indirect costs for in-house developer

70. XYZ Insurance Ltd has an in-house operation which develops software for use in the insurance company's business. In the last income year the software development operation worked on one major project and spent the rest of the time on maintenance work for existing software.

71. The in-house operation employs two staff for software development and maintenance work. Each staff member works 1,000 hours a year.

	Project Development work (hours)	Maintenance work (hours)	Total
Jack	800	200	1,000
Jill	600	400	1,000
Total	1,400	600	2,000

Indirect overhead costs allocated to software development operation for income year: $100,000

Allocation of indirect overhead to project:

Total hours worked	=2,000 hours
Proportion of hours worked for project	=1,400 / 2,000
	=0.7
Indirect overhead costs of project	=$100,000 × 0.7

=$70,000

72. Therefore, besides the direct costs of the project, XYZ Insurance Ltd must capitalise an additional $70,000 of indirect overhead cost for the project. When the development is completed capitalised costs will be deductible under the depreciation regime.

Example 5 – software still undergoing testing

73. XYZ Accounting Ltd is a large national accounting firm. It commissions Brittany to develop a new document management system.

74. At the end of April, Brittany completes the initial development and the software is operational. During May and June the software undergoes extensive testing by two of XYZ Accounting's staff members. During this time a number of issues are identified that require further development. In July, Brittany completed the required changes. A final testing phase is carried out in August. On 1 September it is determined that the software is ready to go live. The actual rollout to all staff occurs on 1 October. A number of minor bugs are identified and Brittany fixes these on 1 November.

75. XYZ Accounting wants to know when it can start depreciating the software. The software was available for use in the taxpayer's business from 1 September and can be depreciated from this date. Prior to this the software was not available for use as it was still being tested and it had not been determined that it could be used as intended. It is not necessary for XYZ Accounting to wait until the software is actually rolled out for use by staff (as long as it is capable of being used). Nor does it matter that the software still contains some minor bugs.

References

Related rulings/statements

IG0007 "Non-resident software suppliers' payments derived from New Zealand – Income tax treatment" Tax Information Bulletin Vol 15, No 11 (November 2003)

"Income Tax Treatment of Computer Software" Appendix to Tax Information Bulletin Vol 4, No 10 (May 1993)

IS 08/02: "Deductibility of Feasibility Expenditure" *Tax Information Bulletin* Vol 20, No 6 (July 2008): 12

IS 10/06 "Deductibility of business relocation costs" Tax Information Bulletin Vol 22, No 8 (September 2010)

Subject references

Abandoned software
Depreciation
Income Tax
Licence
Software
Unsuccessful software

Case references

BP Refinery (Kwinana) Ltd v FCT (1960) 12 ATD 204

Legislative references

Income Tax Act 2007: ss DA 1, DA 2, DB 40B, EE 6, EE 7, EE 18B, EE 36, EE 37, EE 38, EE 39, EE 44 – 47, EE 48 – 52, EE 65, EE 66, subpart FA, sch 14

Tax Administration Act 1994: s 91AAG

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Appendix – Legislation

1. Sections DA 1 and DA 2 state:

DA 1 General Permission

Nexus with income

(1) A person is allowed a deduction for an amount of expenditure or loss, including an amount of depreciation loss, to the extent to which the expenditure or loss is—

(a) incurred by them in deriving—

(i) their assessable income; or

(ii) their excluded income; or

(iii a combination of their assessable income and excluded income; or

(b) incurred by them in the course of carrying on a business for the purpose of deriving—

(i) their assessable income; or

(ii) their excluded income; or

(iii) a combination of their assessable income and excluded income.

General permission

(2) Subsection (1) is called the **general permission**.

Avoidance arrangements

(3) Section GB 33 (Arrangements involving depreciation loss) may apply to override the general permission in relation to an amount of depreciation loss.

DA 2 General limitations

Capital limitation

(1) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a capital nature. This rule is called the **capital limitation**.

...

Relationship of general limitations to general permission

(7) Each of the general limitations in this section overrides the general permission.

2. Section DB 34 states:

DB 34 Research or development

Deduction

(1) A person is allowed a deduction for expenditure they incur on research or development. This subsection applies only to a person described in any of subsections (2) to (5) and does not apply to the expenditure described in subsection (6).

Person recognising expenditure as expense

(2) Subsection (1) applies to a person who recognises the expenditure as an expense for financial reporting purposes-

(a) under paragraph 5.1 or 5.2 of the old reporting standard or because paragraph 5.4 of that standard applies; or

(b) under paragraph 68(a) of the new reporting standard applying, for the purposes of that paragraph, paragraphs 54 to 67 of that standard.

Expenditure on derecognised non-depreciable assets

(3) Subsection (1) applies to a person who—

(a) incurs expenditure, on the development of an intangible asset that is not depreciable intangible property,—

(i) on or after 7 November 2013; and

(ii) before the intangible asset is derecognised or written off by the person as described in paragraph (b); and

(b) derecognises or writes off the intangible asset for financial reporting purposes under—

(i) paragraph 112(b) of the new reporting standard; or

(ii) paragraph 5.14 of the old reporting standard.

Person recognising expenditure otherwise

(4) Subsection (1) also applies to a person who—

(a) recognises the expenditure as an expense for financial reporting purposes because it is an amount written off as an immaterial amount for financial reporting purposes; and

(b) would be required, if the expenditure were material, to recognise it for financial reporting purposes-

(i) under paragraph 5.1 or 5.2 of the old reporting standard or because paragraph 5.4 of that standard applies; or

(ii) under paragraph 68(a) of the new reporting standard applying, for the purposes of that paragraph, paragraphs 54 to 67 of that standard.

Person with minor expenditure

(5) Subsection (1) also applies to a person who—

(a) incurs expenditure of $10,000 or less, in total, on research and development in an income year; and

(b) has written off the expenditure as an immaterial amount for financial reporting purposes; and

(c) has recognised the expenditure as an expense for financial reporting purposes.

Exclusion

(6) Subsection (1) does not apply to expenditure that the person incurs on property to which all the following apply:

(a) the property is used in carrying out research or development; and

(b) it is not created from the research or development; and

(c) it is 1 of the following kinds:

(i) property for which the person is allowed a deduction for an amount of depreciation loss; or

(ii) property the cost of which is allowed as a deduction by way of amortisation under a provision of this Act outside subpart EE (Depreciation); or

(iii) land; or

(iv) intangible property, other than depreciable intangible property; or

(v) property that its owner chooses, under section EE 8 (Election that property not be depreciable) to treat as not depreciable.

Choice for allocation of deduction

(7) A person who is allowed a deduction under this section for expenditure that is not interest and is described in subsection (2), (4), or (5) may choose to allocate all or part of the deduction—

(a) to an income year after the income year in which the person incurs the expenditure; and

(b) in the way required by section EJ 23 (Allocation of deductions for research, development, and resulting market development).

Allocation of deduction for derecognised non-depreciable assets

(7B) A person who is allowed a deduction as provided by subsection (3) must allocate the deduction to the income year in which the relevant intangible asset is derecognised or written off by the person for financial reporting purposes under—

(a) paragraph 112(b) of the new reporting standard; or

(b) paragraph 5.14 of the old reporting standard.

Section need not be applied

(8) A person may return income and expenditure in their return of income on the basis that this section does not apply to expenditure incurred on research or development in the income year to which the return relates.

Relationship with section EA 2

(9) If expenditure to which this section applies is incurred in devising an invention that is patented, the expenditure is not treated as part of the cost of revenue account property for the purposes of section EA 2 (Other revenue account property).

Link with subpart DA

(10) This section overrides the capital limitation. The general permission must still be satisfied and the other general limitations still apply.

3. Section DB 35 defines the following terms:

development is defined in paragraph 8 of the new reporting standard

new reporting standard means the New Zealand Equivalent to International Accounting Standard 38, in effect under the Financial Reporting Act 2013, and as amended from time to time or an equivalent standard issued in its place

old reporting standard means Financial Reporting Standard No 13 1995 (Accounting for Research and Development Activities) being the standard approved under the Financial Reporting Act 1993, or an equivalent standard issued in its place, that applies in the tax year in which the expenditure is incurred

research is defined in paragraph 8 of the new reporting standard.

4. Section DB 40B states:

DB 40B Expenditure in unsuccessful development of software

When this section applies

(1) This section applies when a person incurs expenditure in the development of software for use in the person's business if—

(a) the development of the software is abandoned when the software is not depreciable property of the person; and

(b) the software would have been depreciable property of the person if the development had been completed.

Deduction

(2) The person is allowed a deduction for expenditure incurred in the development of the software to the extent to which no deduction has been allowed for the expenditure under another provision of this Act or under another Act.

Timing of deduction

(3) The deduction is allocated to the income year in which the development of the software is abandoned.

Link with subpart DA

(4) This section overrides the capital limitation. The general permission must still be satisfied and the other general limitations still apply.

5. The relevant provisions from subpart EE state:

EE 6 What is depreciable property?

Description

(1) Depreciable property is property that, in normal circumstances, might reasonably be expected to decline in value while it is used or available for use—

(a) in deriving assessable income; or

(b) in carrying on a business for the purpose of deriving assessable income.

Subsections (2) to (4) expand on this subsection.

Property: tangible

(2) An item of tangible property is depreciable property if—

(a) it is described by subsection (1); and

(b) it is not described by section EE 7.

Property: intangible

(3) An item of intangible property is depreciable property if—

(a) it is within the definition of **depreciable intangible property**; and

(b) it is described by subsection (1); and

(c) it is not described by section EE 7.

...

EE 7 What is not depreciable property?

The following property is not **depreciable property**:

(a) land other than depreciable intangible property, although buildings, fixtures, and the improvements listed in schedule 13 (Depreciable land improvements) are depreciable property if they are described by section EE 6(1):

(ab) a lease of land with a perpetual right of renewal:

(b) trading stock:

(c) livestock to which subpart EC (Valuation of livestock)) applies:

(d) financial arrangements:

(e) excepted financial arrangements other than depreciable intangible property:

(f) property that will not decline in value, as far as its owner is concerned, because, when they dispose of it, they have a right to be compensated for any decline in its value:

(g) property that its owner chooses, under section EE 8, to treat as not depreciable:

(h) property that its owner chooses, under section EE 38, to deal with under that section:

(i) property for whose cost a person other than the property's owner is allowed a deduction:

(j) property for whose cost a person is allowed a deduction under a provision of this Act outside this subpart or under a provision of an earlier Act, except for an asset to which section DU 6(4) (Depreciation) applies.

EE 18B Cost: some depreciable intangible property

For the purposes of section EE 16 and this subpart, the cost to a person for an item of depreciable intangible property or a plant variety rights application (the **amortising item**) includes an amount of expenditure incurred by the person for an item of intangible property (the **underlying item**) if—

(a) the underlying item gives rise to, supports, or is an item in which the person holds, the amortising item; and

(b) the amount of expenditure is incurred by the person on or after 7 November 2013, if the amortising item is 1 of—

(i) a patent or a patent application with a complete specification lodged on or after 1 April 2005:

(ii) plant variety rights:

(iii) a plant variety rights application:

(iv) a design registration:

(v) a design registration application:

(vi) industrial artistic copyright; and

(c) the person is denied a deduction for the expenditure under a provision outside this subpart.

EE 36 Using economic rate or provisional rate instead of special rate

Allowed to use economic or provisional rate

(1) A person may depreciate an item to which a special rate applies by applying, instead, the economic rate applicable to the item or a provisional rate applicable to the item. This subsection is overridden by subsection (2)

Not allowed to use economic or provisional rate

(2) The person must not depreciate the item by applying the economic rate or the provisional rate, if—

(a) a special rate applies to the item; and

(b) the special rate is higher than the economic rate; and

(c) the person applies the special rate to the item for an income year; and

(d) in a later income year, the item's market value declines at a rate equal to or greater than the special rate; and

(e) it is a reasonable conclusion from all the circumstances of the case that the person's purpose, or 1 of the person's purposes, in wanting to change from the special rate to the economic rate or the provisional rate for the later income year is to enable the person to defer the deduction that the person is allowed for the amount of depreciation loss for the item's decline in value.

EE 37 Improvements

When this section applies

(1) This section applies when a person makes an improvement to an item of depreciable property.

Income year in which improvement made

(2) In the income year in which the person makes the improvement, the provisions of this subpart apply to the improvement, as if it were a separate item of depreciable property, in the period that—

(a) starts at the start of the month in which the person first uses the improvement or has it available for use; and

(b) ends at the end of the income year.

Following income years

(3) For income years following the income year in which the person makes the improvement,—

(a) a person who uses the diminishing value method or the straight-line method for the item that was improved may choose to apply subsection (4) or (5), if paragraph (ab) does not apply:

(ab) a person who uses the diminishing value method or the straight-line method for the item that was improved must use subsection (3B) if—

(i) treating the improvement as an item, section EE 31(2A) does not apply, but section EE 31(3A) does apply; and

(ii) the item that was improved is a grandparented structure, or is not a building, is not a used import car, is not an international aircraft, or has not been used or held for use in New Zealand as an item of depreciable property before the date on which the person acquires it:

(b) a person who uses the pool method for the item that was improved must apply subsections (6) and (7).

Improvement compulsorily treated as separate item

(3B) For the purposes of subsection (3)(ab), a person must treat the improvement as a separate item of depreciable property.

Improvement treated as separate item

(4) For the purposes of subsection (3)(a), a person may choose to treat the improvement as a separate item of depreciable property.

Improvement treated as part of item

(5) For the purposes of subsection (3)(a), a person may choose to treat the improvement as part of the item of depreciable property that was improved. They must do 1 of the following for the first income year, after the income year in which they made the improvement, in which they use the improvement or have it available for use:

(a) if they use the diminishing value method for the item, add the improvement's adjusted tax value at the start of the income year to the item's adjusted tax value at the start of the income year:

(b) if they use the straight-line method for the item,—

(i) add the improvement's adjusted tax value at the start of the income year to the item's adjusted tax value at the start of the income year; and

(ii) add the improvement's cost to the item's cost.

Pool method

(6) For the purposes of subsection (3)(b), a person who uses the pool method for the item that was improved must treat the improvement as a separate item of depreciable property. If its cost is equal to or less than its maximum pooling value, they must include it in a pool in the first income year, after the income year in which they made the improvement, in which they use the improvement or have it available for use.

Adjustment of pool's value

(7) When an improvement is included in a pool under subsection (6),—

(a) the pool's adjusted tax value is increased by the improvement's adjusted tax value on the date it is included in the pool; and

(b) the improvement's adjusted tax value at the end of the previous income year is included in **starting adjusted tax value** in section EE 21(5).

EE 39 Items no longer used

When this section applies

(1) This section applies when a person in an income year has an item of depreciable property that—

(a) is no longer used or, because the geothermal energy proving period has ended, becomes unavailable for use under section EE 6(4); and

(b) is not a building, unless the item meets the requirements of subsection (2); and

(c) has not been depreciated using the pool method.

…

Amount of depreciation loss under this section

(3) The person has an amount of depreciation loss under this section and under no other provision of this subpart.

Circumstances

(4) The person has an amount of depreciation loss if—

(a) they no longer use the item in deriving assessable income or carrying on a business for the purpose of deriving assessable income; and

(b) neither they nor a person associated with them intends to use the item in deriving assessable income or carrying on a business for the purpose of deriving assessable income; and

(c) the costs of disposing of the item would be more than any consideration they could derive from disposing of it.

Amount

(5) The amount of depreciation loss is the item's adjusted tax value at the start of the income year.

Adjusted tax value at end of year

(6) The item's adjusted tax value at the end of the income year is zero.

EE 44 Application of sections EE 48 to EE 52

When sections apply

(1) Sections EE 48 to EE 52 apply when a person has consideration from the disposal of an item or from an event involving an item, if—

(a) the consideration is consideration of a kind described in section EE 45; and

(b) either—

(i) the item is an item of a kind described in section EE 46; or

(ii) the event is an event of a kind described in section EE 47.

Exclusions

(2) Sections EE 48 to EE 52 do not apply when—

(a) a person disposes of an item of intangible property as part of an arrangement to replace it with an item of the same kind:

(b) a person's patent application has concluded because a patent is granted to the person in relation to the application:

(c) a person's geothermal well becomes unavailable for use under section EE 6(4) because the geothermal energy proving period has ended:

(d) a person receives, for an item of property, an amount of insurance to which section EZ 23B (Property acquired after depreciable property affected by Canterbury earthquakes) applies.

EE 45 Consideration for purposes of section EE 44

General rule

(1) For the purposes of section EE 44, the **consideration** equals the amount that a person derives excluding any GST charged if the person is a registered person, as modified by subsections (3) to (11) minus the amount (the **disposal cost**) that they incur in deriving that amount, to the extent to which the disposal cost—

(a) is not allowed as a deduction to the person other than as a deduction for an amount of depreciation loss; and

(b) is not counted in "the amount that a person derives".

GST for disposal costs

(1B) All amounts deducted or deductible by the person under section 20(3) of the Goods and Services Tax Act 1985 in relation to the disposal cost described in subsection (1) are subtracted from the disposal costs under that subsection.

Consideration may be zero or negative

(2) For the purposes of section EE 44, the **consideration** may be zero or a negative amount.

Other than market value

(3) If the person has consideration that is not the item's market value, the amount that the person derives is the item's market value. Three qualifications are—

(a) if the person makes a taxable supply, "market value" means the market value minus any GST that would be charged on the supply:

(b) this subsection does not apply to a transfer under a relationship agreement; and

(c) this subsection does not apply in a case described in any of subsections (5) to (10).

Relationship with subpart FC

(4) Subsection (3) does not apply to a disposal of property to which any of sections FC 3 and FC 4 (which relate to the distribution or transmission of property) applies.

Change of use or location of use

(5) The consideration that a person derives from the event described in section EE 47(2) is the item's market value. Two qualifications are—

(a) if the person makes a taxable supply, "market value" means the market value minus any GST that would be charged on the supply:

(b) this subsection does not apply to a transfer under a relationship agreement.

Loss or theft

(6) The amount that a person derives from the event described in section EE 47(3) is the amount of insurance, indemnity, or compensation they receive for the loss or theft (**amount A**). If the person is a registered person, amount A does not include the amount, if any, of GST charged on amount A to the extent to which amount A is treated as being consideration received for a supply of services by the registered person under section 5(13) of the Goods and Services Tax Act 1985.

…

Repossession

(9) The amount that a person derives from the event described in section EE 47(5) is the item's cost minus the net amount paid. Two qualifications are—

(a) if the person is a registered person, the "amount that a person derives" does not include any GST charged on a taxable supply they make:

(b) "net amount paid" means the amount paid by the buyer to the seller for the item under the contract minus any amount refunded by the seller to the buyer.

Other items

(10) The amount that a person derives from the disposal of an item along with any other item, or from the occurrence of an event involving an item that also involves other items, is the item's market value. Two qualifications are—

(a) if the person makes a taxable supply, "market value" means the market value minus any GST that would be charged on the supply:

(b) this subsection does not apply to a transfer under a relationship agreement.

Item leaving New Zealand permanently

(11) The amount that a person derives from the event referred to in section EE 47(10) is described in section EZ 21(1) (Sections EE 45 and EE 47: permanent removal: allowance before 1 April 1995).

EE 46 Items for purposes of section EE 44

Items to which sections EE 48 to EE 52 apply

(1) For the purposes of section EE 44, an item of property to which sections EE 48 to EE 52 apply is an item of depreciable property that a person owns, including—

(a) an item for which the person has been allowed a deduction for an amount of depreciation loss they have had under section EE 33; and

(b) an item to which section CZ 11 (Recovery of deductions for software acquired before 1 April 1993) applies.

Exclusions

(2) Sections EE 48 to EE 52 do not apply to—

(a) an item of property that, on the date on which the disposal or the event occurs, is accounted for in a pool; or

(b) an item of petroleum-related depreciable property; or

(c) an item of intangible property that is excluded depreciable property, other than software; or

(d) a land improvement that is excluded depreciable property of a kind for which no deduction for depreciation was allowed under section 108 of the Income Tax Act 1976.

EE 47 Events for purposes of section EE 44

Events to which sections EE 48 to EE 52 apply

(1) For the purposes of section EE 44, this section describes the events to which sections EE 48 to EE 52 apply.

Change of use or location of use

(2) The first event is the change of use, or change of location of use, of an item of property, as a result of which a person is denied a deduction for an amount of depreciation loss for the item for the next income year. The event is treated as occurring on the first day of the next income year, and includes a change in use of an item for the purposes of the definition of commercial fit-out and a change in the status of a building related to an item for the purposes of that definition.

Loss or theft

(3) The second event is the loss or theft of an item of property, if the item is not recovered in the income year in which the loss or theft occurs.

Irreparable damage or damage rendering building or grandparented structure useless

(4) The third event is—

(a) the irreparable damage of an item of property that is not a building or grandparented structure; or

(b) the damage of an item of property that is a building or grandparented structure, or of the neighbourhood of the building or grandparented structure, causing the building or grandparented structure to be—

(i) useless for the purpose of deriving income; and

(ii) demolished or abandoned for later demolition.

Repossession

(5) The fourth event is the seller's repossession of an item of property to which section EE 3 applies because the buyer wholly or partly fails to pay the consideration. The event is treated as occurring on the date on which the item is repossessed.

Unused geothermal well brought into use

(6) The fifth event is, for a person's geothermal well that is unavailable for use under section EE 6(4) because the geothermal energy proving period has ended, is when the person starts to—

(a) use the well in deriving assessable income or carrying on a business for the purpose of deriving assessable income:

(b) have the well available for use in deriving assessable income or carrying on a business for the purpose of deriving assessable income.

Statutory acquisition

(7) The sixth event is the acquisition of an item of property by a person acting under statutory authority.

Cessation of ownership under section EE 4 or EE 5

(8) The seventh event is the cessation of ownership of a fixture or improvement—

(a) that a lessee is treated as having under section EE 4(2); or

(b) that a person is treated as having under section EE 5(3).

Cessation of rights in intangible property

(9) The eighth event is an occurrence that has the effect that the owner of an item of intangible property is no longer able, and will never be able, to exercise the rights that constitute or are part of the item.

Item leaving New Zealand permanently

(10) The ninth event is described in section EZ 21(2) (Sections EE 45 and EE 47: permanent removal: allowance before 1 April 1995).

EE 48 Effect of disposal or event

Amount of depreciation recovery income

(1) For the purposes of section EE 44, if the consideration is more than the item's adjusted tax value on the date on which the disposal or the event occurs, the lesser of the following amounts is the amount of depreciation recovery income derived by the person :

(a) the amount by which the consideration is more than the item's adjusted tax value on the date on which the disposal or the event occurs; and

(b) the amount given by subsections (1B) and (1C).

Amount for subsection (1)(b)

(1B) The amount for the purposes of subsection (1)(b) is given by the following formula:

item depreciation loss + CZ 11 item amount + DB 64 item amount.

Definition of items in formula

(1C) In the formula in subsection (1B),—

(a) **item depreciation loss** is the total of the amounts of depreciation loss for which the person has been allowed deductions for the item:

(b) **CZ 11 item amount** is the amount of any deduction allowed for the acquisition of the item, for the person, if the item is one to which section CZ 11 (Recovery of deductions for software acquired before 1 April 1993) applies:

(c) **DB 64 item amount** is the amount of the capital contribution for the item, for the person, if the item is one to which section DB 64 (Capital contributions) applies.

Amount of depreciation loss

(2) For the purposes of section EE 44, if the consideration is less than the item's adjusted tax value on the date on which the disposal or the event occurs, the person has an amount of depreciation loss that is the amount by which the consideration is less than the item's adjusted tax value on that date.

Income year of depreciation recovery income

(2B) The person derives the depreciation recovery income in the income year that is the earliest income year in which the consideration can be reasonably estimated.

When subsection (2) does not apply

(3) Subsection (2) does not apply if the item is a building unless—

(a) the building or grandparented structure has been rendered useless for the purpose of deriving income, and demolished or abandoned for later demolition as a result of damage to the building or grandparented structure or of the neighbourhood of the building or grandparented structure; and

(b) *[Repealed]*

(c) the damage is caused—

(i) by a natural event not under the control of the person, an agent of the person, or an associated person; and

(ii) other than as a result of the action or failure to act of the person, an agent of the person, or an associated person.

EE 49 Amount of depreciation recovery income when item partly used for business

Item to which this section applies

(1) This section applies to an item of property that—

(a) is an item to which this section applies, as described in section EE 46; and

(b) is, at any time during the period the person owns it, dealt with in—

(i) subpart DE (Motor vehicle expenditure); or

(ii) any applicable paragraph in section EZ 11 (Amounts of depreciation recovery income and depreciation loss for part business use up to 2004–05 income year); or

(iii) section EE 50.

Depreciation recovery income

(2) If the consideration referred to in section EE 44 is less than or equal to the cost of the item to the person, the amount of depreciation recovery income that the person has is an amount calculated using the formula in subsection (3).

Formula

(3) The formula is—

(all deductions ÷ (base value − adjusted tax value)) x amount of depreciation recovery income

Definition of items in formula

(4) The items in the formula are defined in subsections (5) to (8).

All deductions

(5) **All deductions** is all amounts of depreciation loss for which the person has been allowed a deduction for the item in each of the income years in which the person has owned the item.

Base value

(6) **Base value** has the applicable one of the meanings in sections EE 57 to EE 59.

Adjusted tax value

(7) **Adjusted tax value** is the item's adjusted tax value on the date on which the disposal or the event occurs.

Amount of depreciation recovery income

(8) **Amount of depreciation recovery** income is the amount described in section EE 48(1).

EE 50 Amount of depreciation loss when item partly used to produce income

When subsection (2) applies

(1) Subsection (2) applies when—

(a) a person has an amount of depreciation loss for an item of depreciable property for an income year, other than an amount arising under section EE 48(2); and

(b) at a time during the income year, the item is partly used, or partly available for use, by the person—

(i) in deriving assessable income or carrying on a business for the purpose of deriving assessable income; or

(ii) in a way that is subject to fringe benefit tax; and

(c) at the same time, the item is partly used, or is partly available for use, by the person for a use that falls outside both paragraph (b)(i) and (ii); and

(d) the item is not a motor vehicle to which subpart DE (Motor vehicle expenditure) applies.

Partial use: formula

(2) The deduction the person is allowed for the amount of depreciation loss must not be more than the amount calculated using the formula—

depreciation loss x qualifying use of days ÷ all days

Definition of items in formula

(3) In the formula in subsection (2),—

(a) **depreciation loss** is the amount of depreciation loss for the income year:

(b) **qualifying use days** is the number of days in the income year on which the person owns the item and uses it, or has it available for use, for a use that falls within subsection (1)(b)(i) or (ii):

(c) **all days** is the number of days in the income year on which the person owns the item and uses it or has it available for use.

Other units of measurement

(4) A unit of measurement other than days, whether relating to time, distance, or anything else, is to be used in the formula if it achieves a more appropriate apportionment.

When subsection (6) applies

(5) Subsection (6) applies when—

(a) a person has an amount of depreciation loss for an item of depreciable property arising under section EE 48(2); and

(b) the item was, at any time during the period the person owned it, dealt with in—

(i) subsection (2); or

(ii) any applicable paragraph in section EZ 11 (Amounts of depreciation recovery income and depreciation loss for part business use up to 2004–05 income year); and

(d) the item is not a motor vehicle to which subpart DE applies.

Deduction for depreciation loss: formula

(6) The deduction the person is allowed for the amount of depreciation loss is calculated using the formula—

disposal depreciation loss x all deductions ÷ (base value − adjusted tax value at date)

Definition of items in formula

(7) In the formula in subsection (6),—

(a) **disposal depreciation loss** is the amount resulting from a calculation made for the item under section EE 48(2):

(b) **all deductions** is all amounts of depreciation loss relating to the item for which the person has been allowed a deduction in each of the income years in which the person has owned the item:

(c) **base value** has whichever is applicable of the meanings in sections EE 57 to EE 59:

(d) **adjusted tax value at date** is the item's adjusted tax value on the date on which the disposal or event occurs.

When subsection (9) applies

(8) Subsection (9) applies when—

(a) a person has an amount of depreciation loss for an item of depreciable property for an income year arising under section EE 48(2); and

(b) in the income year in which the amount of depreciation loss arises, the person starts to use the item, or have it available for use, for the purpose of deriving assessable income or carrying on a business for the purpose of deriving assessable income; and

(c) at a time during the income year, the item is partly used, or partly available for use, by the person—

(i) in deriving assessable income or carrying on a business for the purpose of deriving assessable income; or

(ii) in a way that is subject to fringe benefit tax; and

(d) the item is not a motor vehicle to which subpart DE (Motor vehicle expenditure) applies.

Partial use: formula

(9) The deduction the person is allowed for the amount of depreciation loss is calculated using the formula—

disposal depreciation loss x qualifying use days ÷ all days

Definition of items in formula

(10) In the formula in subsection (9),—

(a) **disposal depreciation loss** is the amount resulting from a calculation made for the item under section EE 48(2):

(b) **qualifying use days** is the number of days in the income year on which the person owns the item and uses it, or has it available for use, for a use that falls within subsection (8)(c)(i) or (ii):

(c) **all days** is the number of days in the income year on which the person owns the item and uses it or has it available for use for any purpose.

Other units of measurement

(11) A unit of measurement other than days, whether relating to time, distance, or anything else, is to be used in the formula if it achieves a more appropriate apportionment.

EE 51 Amount of depreciation recovery income when lost or stolen items recovered

When this section applies

(1) This section applies when an item of property to which section EE 47(3) applies—

(a) is recovered in a later income year; and

(b) is still owned by the person; and

(c) is still used or available for use by the person.

Person treated as acquiring item

(2) The person is treated as having acquired the item, on the date of recovery, for its adjusted tax value at the start of the income year in which it was lost or stolen.

Person treated as deriving income: amount

(3) The person is treated as deriving an amount of depreciation recovery income equal to the amount of depreciation loss that the person has under section EE 48(2) for which they have been allowed a deduction.

Person treated as deriving income: income year

(4) The income year in which the person derives the depreciation recovery income is—

(a) the income year in which the item is lost or stolen, if the person chooses that year; or

(b) the income year in which the item is recovered, in any other case.

EE 52 Amount of depreciation recovery income when compensation received

When this section applies

(1) This section applies when a person receives insurance, indemnity, or compensation for an item of property to which this section applies, as described in section EE 46, other than for an item that is lost, stolen, or irreparably damaged.

Compensation subtracted

(2) An amount must be subtracted from the item's adjusted tax value. The amount is the amount by which the insurance, indemnity, or compensation that the person receives is more than the expenditure that the person incurs because of the event for which the person receives the insurance, indemnity, or compensation.

Depreciation recovery income

(3) If the item's adjusted tax value becomes negative in an income year through the application of subsection (2), the negative amount is an amount of depreciation recovery income derived by the person in the income year.

Compensation derived when item no longer owned

(4) If, in the absence of this subsection, the person would derive the amount of insurance, indemnity, or compensation after ceasing to own the item, the person is treated as deriving the amount immediately before the person ceases to own the item.

EE 65 Meaning of maximum pooling value

Meaning

(1) Maximum pooling value, for an item of depreciable property, means the greater of—

(a) $5,000; and

(b) the value set in a determination issued under section 91AAL of the Tax Administration Act 1994 applying to the item.

Increase in specified sum

(2) The Governor-General may make an Order in Council increasing the sum specified in subsection (1)(a).

[The maximum pooling value was increased from $2,000 to $5,000 on 1 July 2015 by the Income Tax (Maximum Pooling Value) Order 2015 with application to the 2015-16 and later income years.]

EE 66 Meaning of poolable property

Meaning

(1) **Poolable property**, for an income year, means an item of depreciable property that a person owns to which subsections (2) to (4) apply.

Not a building

(2) The item is not a building.

Maximum pooling value or globo method

(3) The item—

(a) is acquired in the income year for a cost equal to or less than its maximum pooling value; or

(b) was previously accounted for separately but has, as at the start of the income year, an adjusted tax value equal to or less than its maximum pooling value; or

(c) was accounted for at the end of the 1992−93 income year using, with the Commissioner's permission, the globo accounting method.

Wholly used or subject to fringe benefit tax

(4) The item—

(a) is wholly used or available for use by the person in deriving assessable income or carrying on a business for the purpose of deriving assessable income; or

(b) to the extent to which it is not wholly used or available for use by the person in deriving assessable income or carrying on a business for the purpose of deriving assessable income, is used in a way that is subject to fringe benefit tax.

6. Section EJ 23 states:

EJ 23 Allocation of deductions for research, development, and resulting market development

When this section applies

(1) This section applies when a person has—

(a) a deduction for expenditure incurred on research or development that the person chooses to allocate under section DB 34(7) (Research or development):

(b) a deduction for an amount of depreciation loss for an item used for research or development, that the person chooses to allocate under section EE 1(5) (What this subpart does):

(c) a deduction for expenditure incurred on market development for a product that has resulted from expenditure incurred on research or development that the person chooses to allocate under section EJ 22(2).

Timing of deduction

(2) The person must allocate the deduction to an income year—

(a) in which the person derives an amount of income that is assessable income that the person would not have derived but for—

(i) expenditure that gives rise to a deduction that may be allocated under this section:

(ii) the use or disposal of an item for which the person has an amount of depreciation loss that may be allocated under this section:

(b) to which under Part I (Treatment of tax losses) a loss balance is carried forward for the income year in which the expenditure or depreciation loss was incurred.

Minimum amount of deduction allocated to income year

(3) The person must not allocate to an income year (the current year) an amount of deductions referred to in subsection (1) that is less than the lesser of—

(a) the amount of assessable income referred to in subsection (2)(a) that the person derives in the current year:

(b) the amount of the deductions that have not been allocated to an income year before the current year.

Maximum amount of deduction allocated to income year

(4) The person must not allocate to an income year (the current year) an amount of deductions referred to in subsection (1) that is more than the greater of—

(a) the amount of assessable income referred to in subsection (2)(a) that the person derives in the current year:

(b) the amount of the deductions that—

(i) arise in other income years from which a loss balance may be carried forward under Part I to the current year; and

(ii) have not been allocated to income years before the current year.

7. The relevant provisions from subpart FA state:

FA 6 Recharacterisation of amounts derived under finance leases

When a personal property lease asset is leased under a finance lease, the lease is treated as a sale of the lease asset by the lessor to the lessee on the date on which the term of the lease starts, and—

(a) the lessor is treated as giving a loan to the lessee for the lease asset; and

(b) the lessee is treated as using the loan to buy the lease asset; and

(c) subpart EE (Depreciation), the financial arrangements rules, and the other provisions of this Act apply to the arrangement as recharacterised.

FA 7 Determining amount of loan

Value to lessor

(1) For a lessor under a finance lease, the amount of the loan is determined under section EW 32 (Consideration for agreement for sale and purchase of property or services, hire purchase agreement, specified option, or finance lease).

Value to lessee

(2) For a lessee under a finance lease, the amount of the loan is determined under sections EW 32 and EW 33 (which relate to the value of consideration under the financial arrangements rules).

FA 8 Deductibility of expenditure under finance lease

Lessee treated as owner

(1) The lessee under a finance lease is treated as the owner of the personal property lease asset for the purposes of subpart EE (Depreciation).

Lessor not treated as owner

(2) The lessor under a finance lease is not treated as the owner of the personal property lease asset for the purposes of subpart EE.

FA 9 Treatment when lease ends: lessee acquiring asset

Acquisition treated as sale

(1) When a lessee under a finance lease acquires the personal property lease asset by the date on which the term of the lease ends, the acquisition is treated as the same sale that is treated as occurring under section FA 6.

When lessee or associated person acquires lease asset and later disposes of it

(2) If a lessee under a finance lease, or a person associated with them, acquires the lease asset and later disposes of it for an amount that is more than the consideration they paid for it, the excess is income of the lessee under section CC 11 (Lessee acquiring lease asset on expiry of term of lease).

Allocation and association

(3) For the purposes of subsection (2),—

(a) the excess is income of the lessee in the income year in which the lessee or associated person disposes of the asset:

(b) association is determined at the time of acquisition by the associated person.

Exception

(4) Subsection (2) does not apply if the consideration derived on the disposal is income of the lessee or an associated person under a provision of this Act other than this section.

FA 10 Treatment when lease ends: lessor acquiring asset

When this section applies

(1) This section applies when a finance lease ends by the date on which its term ends.

Acquisition by lessor at end of lease

(2) If the lessee does not acquire the personal property lease asset by the date on which the term of the lease ends, the lessor is treated as having acquired it on that date at its guaranteed residual value. If there is no guaranteed residual value, the consideration is treated as zero. In this section, the consideration is called the **notional sale price**.

Further sale, assignment, or lease

(3) Subsections (4) and (5) apply when the lessor sells, assigns, or leases the lease asset to another person under another finance lease on or after the date on which the term of the original lease ends.

When consideration more than notional sale price

(4) If the consideration is more than the notional sale price,—

(a) to the extent to which it is paid by the lessor to the lessee under the original finance lease, the notional sale price is increased by the amount of the difference; and

(b) to the extent to which it is not paid by the lessor to the lessee under the original finance lease, the amount of the difference is income of the lessor under section CC 12 (Lessor acquiring lease asset on expiry of term of lease) in the income year in which the original lease term ends.

When consideration less than notional sale price

(5) If the consideration is less than the notional sale price, and the lessee is required to pay the amount of the deficit to the lessor, the notional sale price is reduced by that amount.

Acquisition by lessor when lease ends early

(6) If the lease is terminated before the end of its term and the lessee does not acquire the lease asset, the lessor is treated as acquiring it for an amount calculated using the formula—

$$\text{outstanding balance} - \text{release payment}.$$

Definition of items in formula

(7) In the formula,—

(a) **outstanding balance** is the amount of the outstanding balance of the loan on the date on which the lease is terminated:

(b) **release payment** is the amount the lessee paid to be released from their obligations under the lease.

Relationship with section EE 45

(8) Subsections (2) to (6) override section EE 45 (Consideration for purposes of section EE 44).

FA 11 Adjustments for leases that become finance leases

When this section applies

(1) This section applies when a lease is entered into on or after 20 May 1999 and—

(a) the lease is a consecutive or a successive lease—

(i) that is treated as 1 lease under the definition of **lease**; and

(ii) with a term of the lease that the lessor and lessee do not contemplate, at the start of the term, will be more than 75% of the personal property lease asset's estimated useful life; and

(iii) with a term of the lease that is more than 75% of the asset's estimated useful life:

(b) the lease is an operating lease that becomes a finance lease under paragraph (c) of the definition of **finance lease**.

Adjustment required

(2) The lessor and lessee must each adjust their income and expenditure calculated for the lease by including an adjustment in a return of income for the tax year corresponding to the income year in which the lease becomes a finance lease.

Amount of adjustment

(3) The amount of the adjustment is calculated for the relevant person in relation to the period described in subsection (5) using the formula—

finance income − finance expenditure − unadjusted income + unadjusted expenditure.

Definition of items in formula

(4) In the formula,—

(a) **finance income** is the income that would have been derived by the person under the lease if the lease were a finance lease for the period:

(b) **finance expenditure** is the expenditure that would have been incurred by the person under the lease if the lease were a finance lease for the period:

(c) **unadjusted income** is the income derived by the person under the lease:

(d) **unadjusted expenditure** is the expenditure incurred by the person under the lease.

Adjustment period

(5) The period starts on the date on which the lease starts and ends on the last day of the income year in which the lease becomes a finance lease.

Adjustment positive

(6) If the adjustment is positive, the amount is income of the relevant person under section CH 6 (Adjustments for certain finance and operating leases).

Adjustment negative

(7) If the adjustment is negative, the amount is a deduction of the relevant person under section DB 51B (Adjustments for leases that become finance leases).

FA 11B Adjustments for certain operating leases

When this section applies

(1) This section applies when a lease is an operating lease that—

(a) is entered into on or after 20 May 1999 and before 20 June 2007; and

(b) is an arrangement, or part of an arrangement that, on 20 June 2007, meets the requirements of paragraph (c)(i) to (iii) of the definition of **finance lease**; and

(c) has a term of the lease ending after the end of the income year in which 20 June 2007 falls (the **adjustment year**); and

(d) does not meet the requirements of section FA 11(1) before the end of the income year after the adjustment year.

Adjustment required

(2) The lessor must adjust their income and expenditure calculated for the lease asset by including an adjustment in a return of income for the tax year corresponding to the income year after the adjustment year.

Amount of adjustment

(3) The amount of the adjustment is calculated using the formula—

total depreciation losses ÷ 6

Definition of item in formula

(4) In the formula, **total depreciation losses** is the total amount of depreciation loss for the lease asset for which the lessor is allowed a deduction in the period that begins with the start of the term of the lease and ends with the end of the adjustment year.

Income

(5) The amount of the adjustment is income of the lessor under the lease under section CH 6 (Adjustments for certain finance and operating leases) in the income year after the adjustment year.

Adjusted tax value

(6) The adjusted tax value of the lease asset at the beginning of the income year after the adjustment year is the total of the amount of the adjustment and the adjusted tax value that the lease asset would have in the absence of this section.

Depreciation loss

(7) For an income year beginning after 20 June 2007 in which the lease is an operating lease, the amount of depreciation loss allowed for the lease asset other than under section EE 48 (Effect of disposal or event) is five-sixths of the amount of depreciation loss that would be allowed for the lease asset in the absence of this subsection.

8. Schedule 14 states:

…

7 the copyright in software, the right to use the copyright in software, or the right to use software

…