[Interpretation statement IS2228 issued by Adjudication & Rulings in March 2000]

TRANSFERABLE TERM FISHING QUOTA—ACQUISITION AND CONVERSION: Sections 104, 104A, 106, and 107A, Income Tax Act 1976

Summary

All legislative references are to the Income Tax Act 1976 unless otherwise stated.

This interpretation statement sets out the Commissioner's view on how the cost of a Transferable Term Fishing Quota ("TTQ") is to be treated for income tax purposes. The main focus is first, whether the cost of acquiring a TTQ is deductible, and secondly whether a TTQ is "depreciable property" within the definition provided for in the Income Tax Act 1976 ("the Act").

This statement concludes that any expenditure incurred in acquiring a TTQ is not deductible under section 104 as the expenditure is capital expenditure under section 106(1)(a). As expenditure is not deductible under section 104, the provisions of section 104A will not apply.

It has also been concluded that a TTQ is "depreciable property", being fixed life intangible property, by virtue of it being "a right to use land" within the 22nd Schedule of the Act. When a TTQ is converted to an Individual Term Quota ("ITQ"), it is not a "disposal" for the purposes of section 117(10).

The issues

The issues considered in this interpretation statement are:

- Is the acquisition of a TTQ (at a cost) deductible expenditure, and if so, can the cost be amortised. If not, what is the correct treatment of the expenditure?

- Is a TTQ a "right to use land" within the 22nd Schedule and therefore able to be depreciated?

- If a TTQ is able to be depreciated, is the conversion of a TTQ to an ITQ a "disposal" in terms of the Act?

Background

By the early 1980s, fishing pressure had reduced the size of a number of New Zealand's major fisheries stocks. The Quota Management System ("QMS") was introduced in 1986 through amendments to the Fisheries Act 1983. The aim of the QMS was to conserve major fisheries' stocks and improve the economic efficiency of the industry.

Fish species are managed under the QMS through ITQ. An ITQ is the right to catch a specified quantity of quota species each fishing year within a Quota Management Area ("QMA"), in perpetuity.

Due to the many Maori claims pending in relation to the various fisheries, Government agreed that for spiny rock lobster (*Jasus edwardsii*) and packhorse rock lobster (*Jasus verreauxi*), transferable term quota would be allocated instead of individual transferable quota. This necessitated the removal of the existing quota in respect of rock lobster from an ITQ and putting these into a separate category of their own, being TTQ. Rock lobsters were the only species of fish subject to the TTQ system.

The original allocation of TTQ was made by the Ministry of Agriculture and Fisheries ("MAF"), in most instances at no cost to the holder. TTQ were subsequently traded on the open market.

TTQ were first introduced as from 1 April 1990 under the Fisheries Amendment Act 1990 (No.2). Legislation provided for TTQ to have a term life of 25 years expiring on 31 March 2015. This prevented further allocations being made on a permanent basis before the Crown and Maori reached final agreement on a Deed of Settlement for all commercial fishing claims. It was envisaged that this would allow sufficient time for Maori grievances to be settled while not detrimentally affecting the catching capabilities of the commercial fishery.

As from 1 October 1996, TTQ and the relevant interests attached to them were converted to ITQ. No compensatory payments were made in respect of the conversion. As TTQ were, in most instances, originally allocated to holders at no cost, the issues in this statement relate solely to TTQ acquired at a cost, which, in most instances therefore, will be acquisitions subsequent to that initial allocation.

The TEO (in newsletter No 45 (20 September 1991)), stated that the Department's policy (Technical Rulings Para 20.14.6.6) was to treat payments in relation to TTQ as a lease and allow the amount paid for the quota to be amortised over the time TTQ was held. Owing to some interpretative difficulties arising in practice, this statement aims to clarify the law as it relates to the acquisition and subsequent conversion of TTQ.

Legislation

Income Tax Act 1976

Section 104 states:

In calculating the assessable income of any taxpayer, any expenditure or loss to the extent to which it-

(a) Is incurred in gaining or producing the assessable income for any income year; or
(b) Is necessarily incurred in carrying on a business for the purposes of gaining or producing the assessable income for any income year-

may, except as otherwise provided in this Act, be deducted from the total income derived by the taxpayer in the income year in which the expenditure or loss is incurred.

Section 104A states:

(1) For the purposes of this section-

"Accrual expenditure", in relation to any person, means any amount of expenditure incurred on or after the 1st day of August 1986 by the person that is deductible under this Act other than expenditure incurred-

(a) In respect of trading stock; or
(b) In respect of any financial arrangement; or
(c) In respect of a lease to which section 222A to 222D or section 222E of this Act apply; or
(d) Pursuant to a binding contract entered into before 8:30 p.m. New Zealand Standard Time on the 31st day of July 1986:

(2) The amount of the unexpired portion (if any) of any amount of accrual expenditure of any person to be taken into account in any income year shall be-
(a) Where the expenditure relates to the purchase of goods, the amount of expenditure incurred on goods not used in the production of assessable income:
(b) Where the expenditure relates to payment for services, the amount of expenditure incurred on services not performed:
(ba) Subject to subsection (2B) of this section, where the expenditure is incurred by way of monetary remuneration for services that have been performed, the amount of such expenditure that has not been paid in the income year or within such further period as is specified in subsection (2A) of this section:
(c) Where the expenditure relates to a payment for, or in relation to, a chose in action, the amount that relates to the unexpired part of the period in relation to which the chose is enforceable.

(3) Where any person has incurred any accrual expenditure, that expenditure shall be deductible when it is incurred in accordance with the provisions of this Act but the unexpired portion (if any) of that expenditure shall be taken into account in ascertaining the assessable income of the person for the income year in which that expenditure is incurred and subsequent income years.

(4) The amount of the unexpired portion of any amount of accrual expenditure of any person at the end of an income year shall be included in the assessable income of the person for the income year and such amount shall be deductible in the following year.

Section 106(1) states:

Notwithstanding anything in section 104 of this Act, in calculating the assessable income derived by any person from any source, no deduction shall, except as expressly provided in this Act, be made in respect of any of the following sums or matters:

(a) Investment, expenditure, loss, or withdrawal of capital; money used or intended to be used as capital; money used in the improvement of premises occupied; interest which might have been made on any such capital or money if laid out at interest; the acquisition price of any financial arrangement (as defined in section 64B(1) of this Act) to which sections 64B to 64M of this Act applies:

Provided that this paragraph shall not deny a deduction in respect of any amount of expenditure deemed to be expenditure pursuant to sections 64B to 64M of this Act:

Section 111 states:

(1) Where a taxpayer has acquired any property from an associated person (as defined in section 245B of this Act) entitled to a deduction in respect of the depreciation of the property, irrespective of whether or not any deduction has in fact been allowed to that associated person, the Commissioner shall not allow to the taxpayer any greater deduction in respect of the depreciation of the property than that which would have been allowed to the associated person if the associated person had retained the property:

Provided that where any amount so allowed as a deduction to the associated person has been dealt with under section 117 of this Act, the Commissioner may allow to the taxpayer a deduction in respect of the depreciation of the property based on the aggregate of the total of all amounts so dealt with and the amount of that depreciated value of the property immediately before it was acquired by the taxpayer.

(2) This section shall not apply where the Commissioner is of the opinion that the circumstances are such that a deduction in respect of the depreciation of the property based on the actual price or other consideration given for the property should be allowed.

Section 117(7) states:

Subject to this Act, where any depreciable property has been disposed of--
(a) Other than in accordance with a matrimonial agreement; and
(b) Along with any other property; or
(c) For a consideration that the Commissioner believes is not the market value; or
(d) In accordance with subparagraph (ii) or subparagraph (iii) of paragraph (a) of the definition of the term "disposal" in subsection (10) of this section,--
the Commissioner shall deem the property to have been disposed of for a consideration equal to the property's market value or, if the market value cannot be ascertained, for a consideration specified by the Commissioner.

"Annual depreciation rate" is defined in section 107A(1)as:

"Annual depreciation rate", or "annual rate", in relation to any depreciable property of a taxpayer, is the rate applying in respect of that property and that taxpayer pursuant to--
(a) Section 108G of this Act, in the case of fixed life intangible property (not being excluded depreciable property):
(b) Section 108H of this Act, in the case of excluded depreciable property:
(c) Section 108D of this Act, in the case of other depreciable property acquired before the end of the taxpayer's 1994-95 income year:
(d) Section 108E of this Act, in the case of international aircraft acquired in the taxpayer's 1995-96 income year or any subsequent year:
(e) Section 108F of this Act, in the case of other depreciable property acquired in the taxpayer's 1995-96 income year or any subsequent year:

The annual depreciation rate for fixed life intangible property in section 108G states:

The annual depreciation rate for any fixed life intangible property of a taxpayer (not being excluded depreciable property) shall be the rate, expressed as a decimal and rounded to two decimal places (with numbers at the midpoint or greater being rounded up and other numbers being rounded down), calculated in accordance with the following formula:

$$\frac{1}{\text{legal life}}$$

where "legal life" means the legal life of the property at the time at which it was acquired by the taxpayer.

"Depreciable intangible property" is defined in Schedule 22 as being the following:

1. The right to use a copyright.
2. The right to use a design or model, plan, secret formula or process, or other like property or right.
3. A patent or the right to use a patent.
4. The right to use land.
5. The right to use plant or machinery.
6. The copyright in software, the right to use the copyright in software, or the right to use software.
7. The right to use a trademark.
8. Management rights and licence rights created under the Radiocommunications Act 1989.

"Depreciable property" is defined in section 107A(1) as:

"Depreciable property" in relation to any taxpayer, -

(a) Means any property of that taxpayer which might reasonably be expected in normal circumstances to decline in value while used or available for use by persons -
  (i) In gaining or producing assessable income; or
  (ii) In carrying on a business for the purpose of gaining or producing income; but
(b) Does not include -
  (i) Trading stock (as defined in section 85(1) of this Act) of the taxpayer:
  (ii) Land (excluding buildings and other fixtures and such improvements as are listed in the Twenty-first Schedule to this Act):
  (iii) Financial arrangements, as defined in section 64B of this Act:
  (iv) Intangible property other than intangible property which is of a type listed in the Twenty-second Schedule to this Act, which Schedule describes intangible property that has –
    (A) A finite useful life that can be estimated with a reasonable degree of certainty on the date of its creation or acquisition; and
    (B) If made depreciable, a low risk of being used in tax avoidance schemes:
  (iva) Property which the taxpayer has elected to treat as low value property under section 108O of this Act:
  (v) Property the cost of which is deductible under any of sections 104, 127, 131, 134 to 139, 142, 143, and 214F of this Act, or by virtue of an amortisation or other similar deduction available under any section of this Act (such as sections 128A, 128B, 128C, 144, and 222E) other than sections 108 to 108N and section 113A:
  (vi) Property which will not, in respect of the taxpayer, decline in value as a result of any right of the taxpayer to receive any compensation for any such decline in value on disposition of such property:

"Disposal" is defined in section 117(10) as:

(a) Includes--
  (i) The acquisition of property of a taxpayer by any person empowered to do so by statutory authority:
  (ii) Ceasing to use in New Zealand and taking out of New Zealand for use outside New Zealand any property of a taxpayer in respect of which a first-year allowance has been granted under section 112 of this Act (other than under subsection (8) of that section), except where the Commissioner is satisfied that -
    (A) The property has been taken out of New Zealand only temporarily; and
    (B) The property will, after its return to New Zealand, be used in or for the purpose of a business in New Zealand:
  (iii) In any income year, any change of use, or change of location of use, occurring in a preceding income year, as a consequence of which the application of section 108A of this Act gives rise to a nil deduction on account of depreciation for that subsequent income year, in which case the property shall be deemed to have been disposed of on the first day of that subsequent income year and no deduction on account of depreciation shall be claimed in that subsequent income year:
  (iv) Any event whereby the rights which constitute or are part of an item of intangible property will no longer be able to be exercised, at any time, by the taxpayer who owns that property:
  (v) Any event as a consequence of which the property is irreparably damaged; but
(b) Does not include, in the case of intangible property, the disposal of that property as part of an arrangement to replace it with property of the same type.

"Excluded depreciable property" is defined in section 107A(1) as:

"Excluded depreciable property" means, in respect of any taxpayer, any depreciable property-
(a) That was used or was available to be used by the taxpayer for any purpose whatever within New Zealand, other than as trading stock, before the 1st day of April 1993; or
(b) For which a binding contract for its purchase or construction was entered into by the taxpayer before the 16th day of December 1991; or
(c) That is or has been in respect of the taxpayer a qualifying asset within the meaning of section 108N (1) of this Act; or

(d) To the extent that the property is or has been in respect of the taxpayer a qualifying improvement within the meaning of section 108N of this Act; or
(e) That is an intangible asset that was used or was available for use by the taxpayer before the 1st day of April 1993;-
but does not include any item of property in existence at the end of the 1992-93 income year that was permitted by the Commissioner to be accounted for in that income year using any of the standard value, replacement value, or annual revaluation methods:

"Fixed life intangible property" is defined in section 107A(1) as:

any intangible property that-

(a) Is depreciable property; and
(b) Has a legal life which could reasonably be expected, on the date of the creation or acquisition of the property, to be the same as the property's remaining estimated useful life.

"Legal life" is defined in section 107A(1) as:

"Legal life", in respect of any intangible property and the owner of that property, means the number of years and any monthly fraction thereof that the property may remain or continue to remain in existence by virtue of the contract or statute that creates the property for the owner assuming any rights of renewal or extension that are essentially unconditional, or conditional on the payment of pre-determined fees, are exercised:

Fisheries Act 1983

"Transferable term quota" is defined in section 2 of the Fisheries Act 1983 as:

means quota that confers on the holder the right to take rock lobster at any time in the period of 25 years beginning on the 1st day of April 1990 (being quota that may be transferred as if it were individual transferable quota allocated under Part IIA of this Act).

Section 28BA(1) states:

The taking of rock lobster in the quota management areas described in the Third Schedule to the Maori Fisheries Act 1989 is hereby declared to be subject, for the period of 25 years beginning on the 1st day of April 1990, to the quota management system established under this Part of this Act.

Section 28OA(3) further describes a TTQ by saying:

Subject to subsection (4) of this section [which requires a fishing permit to be held], each transferable term quota shall enable the holder, or if there is more than one holder, the combined holders, and any lessee or lessees of the rights to take rock lobster under the quota, to take in total within the quota management area concerned in any year rock lobster, or rock lobster of the species shown in the quota, up to a tonnage shown in the quota.

Section 334 of the Fisheries Act 1996 states:

(1) All transferable term quota (within the meaning of the Fisheries Act 1983) that-
  (a) Was owned by any person immediately before the commencement of this section; and
  (b) Relates to packhorse rock lobster or spiny rock lobster in a particular quota management area-

is hereby **declared to be individual transferable quota** under Part IIA of that Act for the species in that quota management area.

(2) **The conversion** of quota by subsection (1) of this section **does not constitute an allocation of new quota for the purposes of any enactment or rule of law.**
(3) All quota allocated under section 28OA of the Fisheries Act 1983 after the commencement of this subsection, as a result of an appeal to which section 335(1) of this Act applies, shall be allocated in the form of individual transferable quota under Part IIA of the Fisheries Act 1983.
(4) **All individual transferable quota to which this section applies shall be perpetual even though it has been converted** from quota that has been declared by section 28BA of the Fisheries Act 1983 to be subject to the quota management system established under the Act for a period of 25 years commencing on the 1st day of April 1990.
(5) For the avoidance of doubt, it is hereby declared that sections 28E and 28OE(1)(a) of the Fisheries Act 1983 do not apply and have never applied to transferable term quota under the Fisheries Act 1983 or to individual transferable quota for rock lobster created under this section. [Emphasis added]

"Territorial Sea" is defined in the Territorial Sea, Contiguous Zone and Exclusive Economic Zone Act 1977 as:

In this Act, unless the context otherwise requires;

The territorial sea of New Zealand comprises those areas of the sea having, as their inner limits, the baseline described in sections 5 and 6 [and 6A] of this Act and, as their outer limits, a line measured seaward from that baseline, every point of which line is distant 12 nautical miles from the nearest point of the baseline.

And section 7 of the above Act states:

Subject to the grant of any estate or interest therein (whether by or pursuant to the provisions of any enactment or otherwise, and whether made before or after the commencement of this Act), the seabed and subsoil of submarine areas bounded on the landward side by the low-water mark along the coast of New Zealand (including the coast of all islands) and on the seaward side by the outer limits of the territorial sea of New Zealand shall be deemed to be and always to have been vested in the Crown.

The "Continental Shelf" is defined in the Continental Shelf Act 1964 as:

The seabed and subsoil of those submarine areas that extend beyond the territorial limits of New Zealand, throughout the natural prolongation of the land territory of New Zealand, to the outer edge of the continental margin, or to a distance of 200 nautical miles from the baselines from which the breadth of the territorial sea is measured (as described in sections 5 and 6 [and 6A] of the Territorial Sea and Economic Zone Act 1977) where the outer edge of the continental margin does not extend to that distance.

Section 3 of the same Act states:

All rights that are exercisable by New Zealand with respect to the continental shelf and its natural resources for the purpose of exploring the shelf and exploiting those resources are hereby vested in the Crown.

Application of the Legislation

Is the cost of acquiring a TTQ deductible?

Various possible interpretations exist as to the correct treatment of the cost of a TTQ. One interpretation is that the cost may be fully deductible under section 104. If this is so, then the amount paid for the TTQ would be either deductible in full in the year of expenditure, or, more likely, able to be amortised over the period it is held, in terms of section 104A. This section 104A interpretation would also mean that, on the disposition of a TTQ, any unexpired portion of expenditure, as at the date of conversion to an ITQ, would not be required to be added back as income under section 104A(4). The effect of this interpretation would be that a deduction for the full amount of the acquisition cost has been made.

A second interpretation is that the cost of a TTQ is not fully deductible in terms of section 104 because it is capital expenditure in terms of section 106(1)(a). In this situation, the cost of a TTQ cannot be amortised over the period it is held, under section 104A, and, ordinarily, any loss incurred by the taxpayer on the disposition of a TTQ will be a capital loss. This interpretation would also mean that there is no unexpired portion of expenditure as at the date of conversion.

NOTE: If a taxpayer was buying and selling TTQ as part of a business activity, e.g. dealers, traders etc., the treatment of the costs of acquiring TTQ is likely to be different.

Thirdly, if a TTQ is considered to be a capital asset in terms of section 106(1)(a), it may be able to be depreciated.

General capital v revenue principles

In *CIR v Thomas Borthwick & Sons* (1992) 14 NZTC 9,101, Richardson J described the governing approach to the capital/revenue distinction to be the observations of Lord Pearce in *BP Australia Ltd v FCT* ([1966] AC 224). In *BP Australia* the general approach to the question of whether a payment is a capital or revenue expense was outlined by Lord Pierce at p.264:

> The solution to the problem is not to be found by any rigid test or description. It has to be derived from many aspects of the whole set of circumstances some of which may point in one direction, some in the other. One consideration may point so clearly that it dominates other and vaguer indications in the contrary direction. It is a commonsense appreciation of all the guiding features which must provide the ultimate answer. Although the categories of capital and income expenditure are distinct and easily ascertainable in obvious cases that lie far from the boundary, the line of distinction is often hard to draw in border-line cases; and conflicting considerations may produce a situation where the answer turns on questions of emphasis and degree. That answer: "depends on what the expenditure is calculated to effect from a practical and business point of view rather than upon the juristic classification of the legal rights, if any, secured employed or exhausted in the process" (per Dixon J. in *Hallstroms Pty. Ltd. v F.C. of T.* (1946) 72 C.L.R. 634 at p.648).

In *BP Australia*, Lord Pearce applied the tests formulated in *Sun Newspaper Limited and Associated Newspapers Ltd v FCT* ((1939) 61 CLR 337) to determine whether payments made by BP to secure trade tie agreements were capital or revenue. In that decision Dixon J set out three important matters to take into account, namely:

- the character of the advantage sought, and in this its lasting qualities may play a part;

- the manner in which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part; and

- the means adopted to obtain it; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payments so as to secure future enjoyment.

In *CIR v LD Nathan & Co Ltd* ([1972] NZLR 209) the taxpayer company claimed a deduction for the payment of goodwill which had been made in the course of a take-over of another company. The Court of Appeal rejected the claim on the ground that a payment for goodwill is an outgoing of a capital nature. North J identified six tests applicable in border line cases, which have been enunciated in a number of the leading decisions, namely:

- the tests of recurrence;
- the distinction between fixed and circulating capital;
- the distinction between the business entity or structure or the profit-yielding subject as contrasted with the process by which it operates or is operated in order to obtain regular returns by means of regular outgoings or outlays;
- whether the expenditure was made not only once and for all but with a view to bringing into existence an asset or advantage for the enduring benefit of a trade;
- whether the expenditure is an ordinary expenditure of the regular conduct of the business or an organisation for earning profits; and
- the nature of the asset obtained or sought in which its enduring character may play a part.

North P delivered the judgment of the Court, and in the course of his judgment his Honour said at p.215:

> In this case a good deal was made of the fact that the import licences held by Entricans were reviewed each year and a purchaser would have no assurance that the licences would be renewed or indeed that the categories therein mentioned would not be altered or indeed substantially reduced. Likewise, there was no guarantee that Entrican's customers would be willing to do business with Nathans and therefore it was argued there was no certainty of Nathans deriving an enduring benefit from the contract. In my opinion, there is no substance whatever in either of these contentions. I cannot do better than adopt the words of Rich J in the well known Australian case, *Sun Newspaper Limited and Associated Newspapers Ltd v FCT* (1939) 61 CLR 337:
>
>> "The purpose (of the payment) was to buy opposition and secure so far as possible a monopoly. The fact that the benefit was not perpetual does not deprive it of its capital attributes. If physical assets of a terminating or wasting description were bought, no one would say on that account that the money was a revenue expenditure."

In the Commissioner's view, TTQ are the business structure from which any income would be derived. The ability to derive income from a rock lobster operation is only possible by virtue of the taxpayer being in possession of a TTQ. The acquisition cost of a TTQ is a once-only expenditure which brought into existence an asset for the enduring benefit of a trade. The fact that TTQ were not perpetual and only had a limited life of 25 years does not mean that TTQ were not capital in nature (*CIR v LD Nathan).* Those receiving a TTQ are receiving a valuable right that is clearly providing an enduring benefit to the business.

On this basis, it is considered that, because a TTQ is a capital asset, the expenditure in acquiring a TTQ is expenditure of a capital nature and is precluded from deduction under section 104 by virtue of section 106(1)(a). As a result of this conclusion, the cost of a TTQ cannot be amortised under section 104A, because section 104A only applies where expenditure is ordinarily deductible under the Act (whereas TTQ are capital in nature).

Is a TTQ "depreciable property"?

The current depreciation regime was introduced into the Income Tax Act 1976 as taking effect from the 1993/1994 income year. Included as part of the regime were certain types of intangible assets, listed in the 22nd Schedule.

Prior to the current depreciation regime, no provision was made for the depreciation of intangible property of any kind. The ability to depreciate intangible property that existed before the new regime was introduced is denied by the definition of "excluded depreciable property", as provided for at section 107A, which specifically excludes depreciable property used or available to be used prior to 1 April 1993.

Depreciation on intangible assets only applies to those assets acquired after 1 April 1993. As TTQ were first created in 1990, it is only those TTQ acquired after 1 April 1993 that would meet the "depreciable property" definition.

To come within the definition of "depreciable property", the following criteria need to be satisfied:

- The property is depreciable intangible property of a type within the 22nd Schedule
- The property might reasonably be expected, in normal circumstances, to decline in value while used or available for use; and
- The property has been used in deriving gross income; or
- The property has been used in carrying on a business for the purpose of deriving gross income.

The intangible property listed in the 22nd Schedule is as follows:

1. The right to use a copyright.
2. The right to use a design or model, plan, secret formula or process, or other like property or right.
3. A patent or the right to use a patent.
4. The right to use land.
5. The right to use plant or machinery.
6. The copyright in software, the right to use the copyright in software, or the right to use software.
7. The right to use a trademark.
8. Management rights and licence rights created under the Radiocommunications Act 1989.
9. A consent granted under the Resource Management Act 1991 to do something that otherwise would contravene sections 12 to 15 of that Act (other than a consent for a reclamation), being a consent granted in or after the 1996-97 income year.
10. The copyright in a sound recording, if the copyright was produced or purchased by the taxpayer on or after 1 July 1997, and copies of the recording have been sold or offered for sale to the public.

A fishing quota provides the owner with the right to catch a defined percentage of the Total Allowable Commercial Catch and therefore potentially, the only category from this schedule which could be considered to apply to fishing quota, is the “right to use land”.

Is the use of fishing quota the “right to use land” within the 22nd Schedule?

In order to be depreciable property, a TTQ must be depreciable intangible property and therefore it must come within Schedule 22, i.e. it must be the right to use land. Rock lobster, which are the only species of fish subject to the TTQ system, are generally sourced from an area close to the foreshore and are largely found in and around rocks, which are on the sea-bed. They may be collected in any one of three ways: by diving, potting and hand-gathering, but generally, the most favoured is the potting method, which results in the largest catches. Potting takes place in areas where the rocks are easily reached for the purpose of placing pots.

Therefore, it is necessary to decide whether the right to use the sea-bed in the area where the lobster are located constitutes a right to use land.

Neither “right to use land” nor “land” are defined in the Act for the purposes of Schedule 22. “Land”, however, is defined in section 67 in relation to profits or gains from land transactions as:

(a) Any estate or interest in land, whether legal or equitable, corporeal or incorporeal, freehold or chattel; and
(b) Any option to acquire land and any such estate or interest in land;-
but does not include a mortgage.

This definition relates to interests, and in this respect is concerned with the “rights” in land, not what things are considered to actually be land for the purposes of TTQ. We are concerned with what goes to make up land, that is, its composition and in this regard, this definition provides no assistance.

“Land” is also defined in a number of other Acts, e.g. Marine Farming Act 1971, Resource Management Act 1991, Foreshore and Seabed Endowment Revesting Act 1991, that are consistent with an interpretation that land includes the seabed. These definitions, however, are only defined for purposes of those particular Acts – they are not specifically shown to apply for tax purposes.

In the absence of a specific definition of “land” in the Income Tax Act stating what land includes or is composed of, and the fact that the definitions in other legislation apply only to those particular Acts, it is necessary to consider the common law meaning of “land” as to whether the rights in waters include rights to the land below them. If, therefore, it can be established in common law that these rights extend to include that land beneath the water, then, by analogy, any right the Crown has granted to fish in a particular area of water will also include a corresponding right to use or take from the land.

Case law on water rights

A number of cases have considered water rights and whether these extend to include the land below the water.

In *Attorney General for the Province of British Columbia v Attorney General for the Dominion of Canada* [1914] AC 153, the Privy Council had to consider whether the legislature of British Columbia could authorise the Government of the Dominion to grant fishing leases and licenses in both tidal and non-tidal waters, and below the low water mark and in parts of the open sea. Therefore, the case concerned the authority of the legislature of British Columbia. The legislature of British Columbia had granted to the Government of the Dominion a strip of land known as the railway belt. This railway belt included both tidal and non-tidal waters. In discussing what had passed under the grant of the railway belt, the Privy Council said at pp.167-168:

[Their Lordships] are unable to see any ground for construing the grant of the railway belt as excluding such lands situated within it as are covered with water. The solum (ground) of a river bed is a property differing in no essential characteristic from other lands.....

…In the present case, therefore, their Lordships entertain no doubt that the title to the solum and the water rights in the Fraser and other rivers and lakes so far as within the belt are at present held by the Crown in right of the Dominion, and that this title extends to the exclusive management of the land and to the appropriation of its territorial revenues. It remains to consider the consequences as regards fishing rights. These are, in their Lordships opinion, the same as in the ordinary case of ownership of a lake or river bed. **The general principle is that fisheries are in their nature mere profits of the soil over which the water flows, and that title to a fishery arises from the right to the solum.** A fishery may of course be severed from the solum, and then it becomes a profit a prendre in alieno solo and an incorporeal heriditament.....**But apart from the existence of such severance by grant or prescription the fishing rights go with the property in the solum.**

The authorities treat this broad principle as being of general application. They do not regard it as restricted to inland or non-tidal waters. They recognise it as giving to the owners of land on the foreshore or within an estuary or elsewhere where the tide flows and reflows a title to fish in the waters over such lands, and this is equally the case whether the owner be the crown or a private individual. But in the case of tidal waters (whether on the foreshore or in estuaries or tidal rivers) the exclusive character of the title is qualified by another and paramount title which is prima facie in the public. **[emphasis added]**

Their Lordships went on to say (at p.171):

It follows from these considerations that the position of the rights of fishing in the rivers, lakes, and tidal waters (whether in rivers and estuaries or on the foreshore) within the railway belt stand prima facie as follows: In the non-tidal waters they belong to the proprietor of the soil, i.e. the Dominion, unless and until they have been granted by it to some individual or corporation. In the tidal waters, whether on the foreshore or in creeks, estuaries, and tidal rivers, the public have the right to fish, and by reason of the provisions of the Magna Carta no restriction can be put upon that right of the public by an exercise of the prerogative in the form of a grant or otherwise. It will of course be understood that in speaking of this public right of fishing in tidal waters their Lordships do not refer in any way to such fishing by kiddles, weirs, or other engines fixed to the soil. Such methods of fishing involve a use of the solum which, according to English law, cannot be vested in the public, but must belong to the Crown or some private owner.

The Privy Council drew a distinction between tidal and non-tidal waters. Non-tidal waters are those such as lakes, rivers and other inland waterways, excluding those parts of rivers and other waterways which meet the sea, and as such, are tidal. Tidal waters include these areas where non-tidal waters meet tidal waters, at the mouths of streams and in estuaries, as well as the sea coast. The open seas appear to fall into a separate category.

It held that, in respect of non-tidal waters, the right to grant fishing rights is a property right, and as such, exists with the owner of the underlying land. It is a private property right. In the case of rivers, this may well exist with private individuals, but in the case of lakes, the title to the underlying land is typically reserved to the Crown. On the particular facts of the *British Columbia* case, this meant that the right was a property right over which the Government of British Columbia had exclusive authority, except that the Government of British Columbia had specifically granted ownership of the particular land in question back to the Government of the Dominion.

In respect of tidal waters, Viscount Haldane said:

> But in the case of tidal waters (whether on the foreshore or in estuaries or tidal rivers) the exclusive character of the title is qualified by another and paramount title which is prima facie in the public…… So far as the waters are tidal the right of fishing in them is a public right subject only to regulation by the Dominion Parliament.

In respect of the rights relating to the open seas, the Privy Council said that it did not propose to express an opinion on the question of whether the Crown has a right of property in the bed of the sea below low water mark. However, it went on to say (at p.173):

> Their Lordships have already expressed their opinion that the right of fishing in the sea is a right of the public in general which does not depend on any proprietary title, and that the Dominion has the exclusive right of legislating with regard to it.

In *re Ninety-Mile Beach* [1963] NZLR 461, the New Zealand Court of Appeal considered whether the Maori Land Court had jurisdiction to consider claims over the foreshore. The Court of Appeal did not actually consider whether the foreshore was land, but it is implicit from their discussions that they clearly considered it to be so. The following are some examples:

> …the question we are asked to consider in this appeal is whether the jurisdiction of the Maori Land Court to investigate the title to customary land and to issue freehold orders in respect thereof extends to the investigation of title to and the issue of freehold orders in respect of land lying between mean high water mark and mean low water mark... (p.466).

> The main submission made by the Solicitor General was that on the assumption of sovereignty by her majesty Queen Victoria, the foreshore of the lands of New Zealand including the land in question became and has ever since remained vested in the Crown, and that the Maori Land Court-as it is now called- has not and never did have jurisdiction to investigate the title to land below the high water mark. (p.467)

> Has the Maori Land Court jurisdiction to investigate title to, and to issue freehold orders in respect of the foreshore- namely that part of the land which lies between the mean high water mark and the mean low water mark? (p.474)

> The facts were that on 13 December 1864 the Crown had made a grant of land on the foreshore at Timaru down to the low water mark... (p.476)

The issue of ownership of the river bed was also considered in *re the bed of the Wanganui River* [1955] NZLR 419*,* where the Court of Appeal considered the river bed to be land. Cooke J said (at p.429):

> …by the Treaty the soil of the bed became vested in the Crown as part of its demesne [domain] lands and unaffected by any native customary title.

North J went on to say (at pp.461-463):

> I can see no justification for the Solicitor General's argument that some distinction is to be drawn between dry land and land covered with water; both were tribal territory, and both had their uses and served the needs of the tribe.
>
> …It seems to me however, to be clear, that this section recognised the possibility of the existence of rivers running through the tribal lands, and in the absence of any statutory provision excluding the soil of the bed of the rivers from the tribal customary lands, it is difficult to imagine that such river beds could have been excluded from a certificate of title granted to a tribe in respect of its tribal lands.

It is implicit in the two New Zealand cases above that there is no distinction between title to bare land and title to land over which water is flowing. The rights which attach to waters are derived from the rights to the land below such waters. However, the nature of the particular land being looked at in these cases is such that it would normally be subject to the Land Transfer Act 1952, whereby the owner would, in effect, hold a title to the land, regardless of whether water flowed over it or not. The rights to a TTQ are rights in the open sea, an area not subject to the Land Transfer Act and this may be of significance.

In *British Columbia*, the Privy Council, whilst recognising that, prima facie, the right to fish in tidal waters or open seas is primarily a public right, held that the Dominion (in whom the title was vested, in this instance the Crown of New Zealand) may legislate against this right. This means that the proprietary right to the territorial waters is vested in the Crown. Legislation of this nature has been effected by the provisions of section 7 of the Territorial Sea, Contiguous Zone, and Exclusive Economic Zone Act 1977, which states that the sea-bed to the outer limits of the territorial waters is vested in the Crown, and as such, is a legal interest.

As referred to earlier, the area where rock lobster are gathered is within the territorial waters of New Zealand, meaning that the area where rock lobster are gathered is vested in the Crown. If, as the Privy Council considered to be the case in *British Columbia*, the title to a fishery arises from the right to the solum, then this right arises by virtue of there being an interest in the solum. Hence, the Crown, by virtue of it having the legal interest in the land, also has title to the fishery above such land.

The enactment of the Fisheries Act 1983 (and the subsequent amending Acts) specifically provided the Crown with sole rights to grant to others the right to take species of fish from particular waters. In addition, the Fisheries Act also provided for the holder of a fishing quota to transfer by way of sale or lease the rights held in a TTQ. On the basis of the *British Columbia* case, the Crown has the ability to permit others to fish in the Crown's solum, i.e. to take some of its interest in the land (the fish). This raises the question of whether the right to take fish is the right to use land.

Is the right to take fish a "right to use land"

The meaning of the “right to use land” should be considered from the perspective of its context for the purposes of Schedule 22. Schedule 22 allows the depreciation of certain intangible assets used by the taxpayer in the income earning process. This means that the intangible “right to use land” must be a right which is exercised in the course of the taxpayer deriving his or her income.

A fishing quota confers on the holder a right to take fish, whose sale provides income to the holder.

However, the issue is whether the right to use the water to take fish, means that it is a right to use the land below that water. From all three cases referred to earlier it has been established that, where there is title to an area, that area is defined by reference to the sub-soil, and therefore forms part of that title. As stated above, the Crown has vested in it the territorial waters and the sea-bed below such waters. On this basis, we consider that a fishing quota, which confers on the holder the right to use the waters for the purpose of taking the entitlement of fish, also includes the right to use the land below those waters. This is on the basis that the “right to use” is the right to use the land to the extent necessary to exercise the rights conferred by the fishing quota.

Additionally, in the case of rock lobster it can also be argued that, as the lobster's habitat is, usually, on the sea-bed or rocks resting on the sea-bed, the lobster themselves are gathered from the land. This conclusion holds equally for all other species of fish.

Is a TTQ a profit à prendre?

It could be argued that a TTQ, being a right to use land, is a profit à prendre. A profit à prendre (a right to take profits from the land) also includes a right to use land as it confers on the holder a right to take from the water, including the land below it. However, a profit à prendre is an interest in land, which is a tangible right. Therefore, although a TTQ has many of the same characteristics as a profit à prendre, the better view is that a TTQ is not a profit à prendre. To elaborate on this view, it is necessary to determine what distinguishes a TTQ from a profit à prendre.

The first characteristic of a profit à prendre is that it is a right to take something off land. The cases have held that this extends to taking fish from water which flows over land.

In *Fitzgerald v Firbank* [1987] 2 Ch 96, the plaintiffs held an exclusive right of fishing with rod and line for a specified period in a certain part of a river. The plaintiffs succeeded in bringing an action for trespass against the defendants, who had polluted the river by way of discharge of clay and gravel-washings. The pollution resulted in fish being driven almost entirely out of the plaintiff’s fisheries, interfered with the natural spawning process, deprived the fish of food and rendered the remaining fish unsuitable to take.

Lindley LJ cited with approval the dictum in *Smith v Kemp* (1693) 2 salk.637 on the subject of “piscary” where the Court said:

If a grant be de liberia piscaria, the grantee shall have the property of the fish there, and shall maintain trespass for fishing there.

Lindley LJ went on to say (at p.99):

The right to fishing includes the right to take away fish unless the contrary is expressly stipulated. I have not the slightest doubt about that. Therefore, the plaintiffs have got a right of some sort as distinguished from a mere revocable licence. What is that? It is a good deal more than an easement; it is commonly called a profit à prendre. It is of such a nature that he can bring an action for trespass at common law for the infringement of those rights.

The second characteristic of a profit à prendre is that it is an interest in land. This means that the profit à prendre needs to have been created by a person with a legal interest in the land. Section 90 of the Land Transfer Act 1952 also specifically provides for the registration of the interest in a profit à prendre on the legal title to the land. In this respect, a profit à prendre confers rights of a possessory nature. As a result of this legal interest, the owner of a profit à prendre can bring an action for trespass at common law for an infringement of those rights.

However, although both a TTQ and a profit à prendre have these similar features, the right of action in respect of each is not the same. A person holding the rights in a profit à prendre can bring an action for trespass for an infringement of those rights, because a profit à prendre is a property right and the right is actionable as a right in rem. This feature can be distinguished from a TTQ where, if an unauthorised person was fishing in the quota area or prevented a TTQ holder from exercising his or her rights in any manner, no action for trespass is available to the holder of a TTQ. The legal right of action (e.g. prosecution action) for any unauthorised conduct (e.g. trespass) lies with the Crown, exercised by the Ministry of Fisheries on behalf of the Crown.

In addition to this, the rights in a TTQ, in contrast to those in a profit à prendre, are not registerable under the Land Transfer Act because the territorial waters and land below such waters are not subject to that Act. The case law referred to above indicates that, generally, a fishing right is a profit à prendre. However, based on the analysis above, we consider that the rights in a TTQ, whilst similar to those in a profit à prendre, can be sufficiently distinguished so as to conclude that a TTQ is not an interest in land and therefore, not a tangible interest in land.

Can the property be reasonably expected in normal circumstances to decline in value?

In order to be "depreciable property", property must also meet a further test, i.e. the requirement that it might reasonably be expected to decline in value while used or available for use.

In the Commissioner's view, as a TTQ existed for a fixed term only, prima facie, the value of such quota would reasonably be expected to decline, in terms of resale value, as the term came closer to an end.

However, it is acknowledged that extraneous factors such as economic conditions and scarcity of rock lobster may also directly affect the value of the quota during the term of the right, so that at a given point in time the value may fluctuate upwards or downwards.

The fact that property may fluctuate in value over the period of its life was recognised by the Valabh Committee in their report "Tax Accounting Issues" (Feb 1991) which recommended the inclusion of fixed life intangible property in the definition of "depreciable property". It said (at p.111):

In general, the approach adopted by the Commissioner has been to exclude from the class of depreciable property those assets that are not used in the derivation of assessable income, as well as those assets that are not expected "systematically" to decline in value over the estimated useful life of the asset.

This approach has not resulted in the exclusion of assets that exhibit an increase in their nominal value at some stage over their useful life. Assets that are expected to fall in value over their estimated useful lives are still depreciable even if they increase in value at certain times during that period. However, it has resulted in the exclusion of certain "investment" assets that can be expected to appreciate in value over most of the asset's life (such as, original works of art, vintage cars etc.), even though it is recognised that the value of those assets at the end of their useful lives will inevitably be less than their original cost.

It is noted that two tests are to be applied when considering an expectation of decline:

- The decline must be reasonably expected.
- Consideration is made having regard to normal circumstances.

"Reasonably", as an adverb, is not defined specifically in the Concise Oxford Dictionary. However, "reasonable" is stated to mean:

1. having sound judgment; moderate; ready to listen to reason. **2**. In accordance with reason, not absurd. 3. Within the limits of reason; not greatly less or more than might be expected.

The "reasonable expectation" is that from the point of view of the person who is purchasing or intending to purchase, in this instance, a TTQ. This is because it is only this person who is concerned with whether a TTQ would appreciate or decline in value. A factor most likely to be taken into account by an intending purchaser when making any purchase decision. This also means that it is an initial test, taken at the time of acquisition. A similar test is provided for in the penalties regime where, in assessing whether a taxpayer has exercised "reasonable care", the effort required of the taxpayer is commensurate with that of a reasonable person in the taxpayer's circumstances.

On this basis an interpretation of the dictionary definitions above would mean that the taxpayer is only expected to exercise such an expectation based on practical or sensible factors, and relative to what a taxpayer in that person's position would be expected to know.

"Normal" is defined in the Concise Oxford Dictionary as meaning:

conforming to a standard; regular, usual, typical.

"Normal circumstances" are circumstances which, according to past practice have shown a typical pattern or outcome. Exceptional factors which may arise or be present when considering a "reasonable expectation" are not ones that are required to be considered in "normal circumstances".

In summary, the words "can be reasonably expected" and "in normal circumstances" mean that whether there is likely to be a decline in value of an asset over the period it is held, is to be regarded from the point of view of the ordinary taxpayer who is purchasing a TTQ. In the absence of exceptional circumstances, such "reasonable expectation" will therefore need to be based on historical evidence of whether, in the past, these type of assets have generally declined in value over the period they are held. Whether an asset appreciates or declines in value is relative to the particular class of asset and any exceptional circumstances at the time, and such tests are to be appropriately determined in the context of each asset.

The legislation makes it clear that a TTQ can only exist for a period of 25 years, and apart from normal market fluctuations in value according to supply and demand, it could be reasonably expected that the value of the quota would, in normal circumstances, decline over this period whilst being used or available for use.

In view of this, and the earlier conclusion that TTQ are a "right to use land" within the 22nd Schedule, TTQ are "depreciable property" within the definition provided for in section OB 1 of the Act.

However, the definition of "depreciable property" in referring to intangible property of the type listed in the 22nd Schedule also states that **such Schedule describes** intangible property which:

1. has a finite useful life that can be estimated with a reasonable degree of certainty on the date of its creation or acquisition; and
2. has, if made depreciable, a low risk of being used in tax avoidance schemes

A literal reading of the words "**such schedule describes**" suggests that this is a direction to the 22nd Schedule which describes what one might find there. On this basis, a literal reading suggests this wording is merely an ancillary point, in this instance, adding description to the types of assets covered by the 22nd Schedule, as an aid to interpretation. Additionally, the type of factors described in 1 and 2 above would not, in ordinary circumstances, be factors which Parliament would expect the taxpayer to have to consider. Adopting this interpretation means that these are tests to be applied by Parliament, through its advisors, prior to the addition of the asset category to the 22nd Schedule.

However, it is possible that these two requirements are not in fact tests to be applied by Parliament's advisors prior to the addition of the asset category to the 22nd Schedule, but are additional tests which fall to the taxpayer to satisfy, **after** it has been established that the asset is one of the types within the 22nd Schedule. As the meaning of this provision is not clear, it is necessary to consider whether TTQ would meet these requirements if in fact, they are additional requirements to be satisfied.

Finite useful life

In respect of the first element, it must be possible to determine a finite life for the asset at its creation or date of purchase. In regards to TTQ, the definition of Transferable Term Quota in section 2 of the Fisheries Act 1993 states that a right to take rock lobster is conferred for a period of 25 years beginning on the 1st day of April 1990. The rights conferred allow the collection of rock lobster up to a certain tonnage per year. This means the quota can be re-used in each of the 25 years on a continual basis. Therefore, a TTQ has a useful life for the whole of its existence, that is, 25 years. As the life of a TTQ has been written into legislation at the date of creation, this element has been satisfied as a matter of fact, and would in all likelihood be known to any prospective purchaser. It would definitely be known to Inland Revenue. For these reasons, we consider that either the taxpayer or Inland Revenue can determine this factor as it relates to TTQ at the time of creation, or, for purchasers, post creation.

Low risk of being used in tax avoidance schemes

The type of situation possibly envisaged by this provision would be where the asset is sold at an inflated value. Generally, these types of arrangements take place between associated persons. However, the legislation provides a remedy for this situation in section 111 [EG 17]. On this basis, it can be inferred that a possible situation which section 111 does not specifically cover, is where the sale price of an asset is inflated between non-associated persons. However, there is a possibility that the Commissioner could apply the provisions of section 117(7) [EG 19(7)] to deem the property to have been disposed of for a consideration equal to the property's market value.

In the case of a TTQ, it would not have been possible for a taxpayer to purchase the asset for the purpose of being used in a tax avoidance scheme. This is because the asset has never previously been held to be depreciable property, and therefore could never have been originally acquired by a taxpayer for any tax avoidance purpose relating to depreciation. In addition to this, TTQ are no longer in existence and therefore it is not now open to any taxpayer to acquire a TTQ, and hence cannot be used for the purposes of any future tax avoidance scheme.

Based on the wording of the legislation, the correct interpretation is that where an asset has been included in the 22nd Schedule it has already met the two requirements above, and therefore these factors are not required to be considered separately in relation to any of the types of assets included in the 22nd Schedule. These factors have already been considered before the asset has been added to the 22nd Schedule.

Excluded depreciable property

Although a TTQ can be considered to come within the definition of "depreciable property", it must not be depreciable property which is "excluded depreciable property". "Excluded depreciable property" is defined as depreciable property:

(a) That was used or available to be used by the taxpayer for any purpose whatever within New Zealand, other than as trading stock, before the 1st day of April 1993; or
(b) For which a binding contract for its purchase or construction was entered into by the taxpayer before the 16th day of December 1991; or

(c) That is or has been in respect of the taxpayer a qualifying asset within the meaning of section 108N (1) of this Act; or

(d) To the extent that the property is or has been in respect of the taxpayer a qualifying improvement within the meaning of section 108N of this Act; or

(e) That is an intangible asset that was used or was available for use by the taxpayer before the 1st day of April 1993;--

but does not include any item of property in existence at the end of the 1992-93 income year that was permitted by the Commissioner to be accounted for in that income year using any of the standard value, replacement value, or annual revaluation methods:

Assets considered to be "excluded depreciable property" include assets used or available for use prior to 1 April 1993. This means that only those TTQ acquired after that date can be depreciated.

Having determined that TTQ are depreciable property, provided they were acquired after 1 April 1993, the next issue is the rate of depreciation that applies to these assets.

The definition of "annual depreciation rate" states that the rate to be applied in the case of "fixed life intangible property" is, pursuant to section 108G, calculated as the fraction of one over the legal life of the asset.

In order to be "fixed life intangible property" the property must be depreciable property and have a legal life which could reasonably be expected, on the date of creation or acquisition to be the same length as the property's remaining estimated useful life. As it has already been established earlier that a TTQ is depreciable property, it now needs to be established that a TTQ has a "legal life" equal to its "useful life".

"Legal life" is, in respect of intangible property and the owner of that property, the number of years and any monthly fraction thereof that the property may remain or continue to remain in existence by virtue of the contract that creates the property for the owner assuming any rights of renewal or extension that are essentially unconditional, or conditional on the payment of pre-determined fees, are exercised (section 107A(1)).

TTQ were created pursuant to section 28AB of the Fisheries Act 1993 for a period of 25 years beginning on 1 April 1990. The legal life, therefore, expires on 31 March 2015. As the tonnage available to be caught under the quota system remains constant throughout each of those 25 years, and ceases on the same date as the legal life, it can be said that the useful life of a TTQ is equal to its legal life. On this basis, a TTQ meets the definition of "fixed life intangible property" and is subject to such rate as provided for in section 108G.

The rate set out for fixed life intangible property in section 108G is the formula, "one over the legal life". The depreciation rate will be calculated on a straight-line method, from the date of acquisition and with regard to that period remaining up until 31 March 2015.

In summary, a TTQ is depreciable property as it is a "right to use land" within the 22nd Schedule and the rate of depreciation is that rate provided for in section 108G. The ability to depreciate will only apply to those TTQ acquired on or after 1 April 1993.

Having determined that a TTQ is "depreciable property", it is necessary to now look at the effect of the conversion of a TTQ to an ITQ as from 30 September 1996, and whether this constituted a "disposal" in terms of the legislation. If in fact the conversion of a TTQ to an ITQ constitutes a "disposal", any depreciation claimed in those years from 1 April 1993 until 30 September 1996 will need to be taken into account when determining any income tax liability, that is, a depreciation "clawback".

If a TTQ is able to be depreciated, is the conversion of a TTQ to an ITQ a "disposal"?

In order for a TTQ to be a "disposal" on its conversion to an ITQ, it will need to satisfy one of the provisions within the definition of "disposal" in section 117(10). Two provisions within this section relate to intangible property that could potentially apply to TTQ. These are that a "disposal":

- Includes any event whereby the rights which constitute or are part of an item of intangible property will no longer be able to be exercised, at any time, by the taxpayer who owns that property.

- Does not include, in the case of intangible property, the disposal of that property as part of an arrangement to replace it with property of the same type.

Is the conversion of a TTQ an event whereby the rights which constitute or are part of an item of intangible property mean that it will no longer be able to be exercised, at any time, by the taxpayer who owns that property?

Although "disposal" is defined specifically in relation to depreciation, the words of the legislation state that the definitions given are inclusive. This means that the definition of "disposal" in section 117(10), which includes the two factors above, is not exhaustive. In view of this, it is necessary to also look at the meaning given to the word at common law.

The meaning of the word "disposal" or "disposition" has been considered in a number of jurisdictions.

In *Ward v CIR* [1955] NZLR 361, Gresson J referred to the meaning given to "disposition" by the House of Lords in *Duke of Northumberland v AG* [1905] AC 406. He said:

> [It] is clear that the terms "disposition" and "devolution" must have been intended to comprehend and exhaust every conceivable mode by which property can pass, whether by act of parties or by act of the law.

In *FCT v Wade* [1951] 84 CLR 105*,* the High Court of Australia had to consider whether diseased cattle, destroyed compulsorily and for which compensation had been received, had been disposed of "by sale or otherwise". On the meaning of "disposed" Dixon and Fullager JJ said:

> The words "disposed of" are not words possessing a technical legal meaning, although they are frequently used in legal instruments. Speaking generally, they cover all forms of alienation.

In *Grey v IRC* [1958] 2 All ER 428, Lord Evershed MR said:

> The word "disposition" is one of wide import, general rather than precise. Many context could no doubt be found in which the word or its derivatives would cover any means whereby the owner of any right or property succeeded in getting rid of that which he formally enjoyed…..The meaning of the word must be discerned from and as I think limited by the context.

The House of Lords affirmed the judgment, but no specific comment was made on the general meaning of disposition.

Victory Hotels Ltd v MNR [1962] CTC 614 concerned the timing of when a business had been disposed of. The Court said that "disposed of" as used in the relevant section meant:

> "to part with", "to pass over the control of the thing to someone else" so that the person disposing no longer has the use of the property.

In *Coles Myer Ltd v Commissioner of State Revenue* 98 ATC 4,537, Ormiston JA considered the meaning of the word "transfer". However, in his judgment, he distinguished a transfer from a disposition. He said that transfer "is not a mere disposition, a ridding oneself of the right or interest".

The case law above supports the view that, for a disposition to occur, all that is required is an alienation of property. However, other cases support the view that there must be intention and activity on the part of the disposer and that the property must remain in existence after it has been disposed of.

These further requirements are discussed in *Wade* (referred to above), where the High Court of Australia held that diseased cattle had not been disposed of "by sale or otherwise". The Court reasoned:

> Such a thing involves no voluntary act on the part of the taxpayer, no alienation of property on his part and, except for the fact that it is authorised by law and compensation is payable, can hardly be differentiated from the destruction of the assets by external force or accident.

In *Henty House Property Ltd (in voluntary liquidation) v FCT* 10 ATD 231, a building was resumed by the Commonwealth from the taxpayer who received a lump sum payment as compensation. In considering the meaning of the phrase "disposed of, lost or destroyed", the Full High Court said:

> No doubt the notion primarily conveyed by the words "disposed of" is the notion of a disposition by the taxpayer; but it is not necessarily so confined, and the use of the passive voice, without specific words of restriction referring to the person by whose act the disposal takes place, leaves ample room for a construction in keeping with the general tenor of the section, and with its place in the scheme which ss 54 to 62 provide. The entire expression "disposed of, lost or destroyed" is apt to embrace every event by which property ceases to be available to the taxpayer for use for the purpose of producing assessable income, either because it ceases to be his, or because it ceases to be physically accessible to him, or because it ceases to exist. In the context of s 59 there is ample reason for rejecting a narrow construction. In particular, the words "is disposed of" are wide enough to cover all forms of alienation, as Dixon and Fullagar JJ remarked in FCT v Wade, and they should be understood as meaning no less than "becomes alienated from the taxpayer," whether it is by him or by another that the act of alienation is done. Neither the words themselves nor the setting in which they appear afford any support for the view that cases of involuntary alienation fall outside their meaning.

It is obvious that the case for a construction of the expression "disposed of" as extending to compulsory acquisition is even stronger. The words "disposed of" are not technical words. They mean disposed of in a commercial sense. Similar words in other acts have been given a very wide meaning in suitable contexts.

Compulsory acquisition was also considered in New Zealand in *Public Trustee v CIR* [1961] NZLR 1034. The issue was whether land compulsorily acquired under the Public Works Act was a disposition for the purposes of section 79(1)(c) of the Income Tax Act which is now section CD 4. In discussing the issue Hutchinson J, of the Supreme Court, said:

In their ordinary meanings, "sale" and "disposition" require intention and activity on the part of the person selling or disposing. It was put thus by Viscount Simmonds, in relation to the words "sale" and "sold", *in Kirkness v John Hudson & Co Limited* [1955] All ER 345: "To say of a man who has had his property taken from him against his will and been awarded compensation in the settlement of which he has had no voice, to say of such a man that he has sold his property appears to me to be as far from the truth as to say of a man who has been deprived of his property without compensation that he has given it away. Alike in the ordinary use of language and in its legal concept a sale connotes the mutual assent of two parties."
…
It was put thus in the High Court of Australia, in relation to the word "disposed", in *Henty House Pty. Ltd. v. Federal Commissioner of Taxation* (1953) 5 A.I.T.R. 557: "No doubt the notion primarily conveyed by the words 'disposed of' is the notion of a disposition by the taxpayer…" (ibid., 560) and by Fullager J., in the same case: "The term 'disposed of' is not a technical term, and its 'ordinary' "or 'popular' meaning does not, to my mind, cover a case in which a person is deprived of his property against his will or without his consent".

But, of course, those words may bear an extended meaning if the context requires it.

There has been case law considering disposition in relation to the redemption of shares. In *Case Q52,* Barber J found that the redemption of the shares was a "disposition" for the purposes of section 65(2)(e). The taxpayers had not bought the shares for resale, but had bought them for redemption at a higher price than they had paid for them. The redemption involved a transfer of property - the shares on redemption were not extinguished, as they would remain part of the authorised share capital of the company. That redemption should have resulted in a profit which Barber J considered would have been assessable. This meant that the transaction was revenue in character so that the loss should be deductible. Barber J had this to say about what amounts to a disposition in this context (at p.5,298):

I agree with Mr Wood that when redeemable preference shares are redeemed there is the fulfilment of a contract between the company and the shareholder rather than a sale and, after redemption, the former shareholder no longer has any interest in the shares. I do not think that the shares can be regarded as being extinguished because they remain part of the authorised capital of the company and can be re-issued to someone else. While there is no sale by the shareholder to the company at the time of redemption, I consider that the property in the shares does pass from the shareholder to the company. The shareholder has parted with his rights in return for a redemption payment. That seems to me to be a disposition in terms of the above statement of Gresson J in Ward v CIR [[1965] NZLR 367,370] and in terms of the various dictionary definitions. It may seem that Public Trustee v CIR [[1961] NZLR 1,034] and Railway Timber Co Ltd v CIR [(1976) 2 NZTC 61,172] run counter to my view in that they seem to require a positive act from the disponer. I respectfully agree with Hutchinson J when he said at p.1,042 of Public Trustee v CIR:

> "In their ordinary meanings, 'sale' and 'disposition' require intention and activity on the part of the person selling or disposing."

> However, I do not think that this is an ordinary situation, and, in any case, I consider that there has been "intention and activity" on the part of the objectors. They always intended redemption for 6c more than they paid and they intended to enter into the activity of completing redemption procedures with the company. Had that arrangement been completed, the profit should have been returned as assessable under the second limb of s 65(2)(e). In terms of *Inglis*, this means that the transaction was revenue in character so that the loss should be deductible.

However, Willy DJ in *Case Q57* did not seek to rely on the shares remaining in the hands of the company. His Honour rejected any argument that there was no disposition because the shares once redeemed were no longer in existence on the basis that continuing existence of the property disposed of was a necessary feature of the notion of disposition. His Honour preferred to rely on the authorities which emphasised the broad meaning of "disposition" (e.g. *Ward*) - an approach he considered had been supported by Barber J in *Case* Q52. Willy DJ considered that the passing of the shares from the shareholder back to the company clearly created a new legal and equitable interest in that property, i.e. there was passing of property, because the company on the one hand would be relieved of a liability to pay for the cost of the moneys acquired from the investing public, and the investor on the other hand had received back his money plus a capital profit. In his Honour's view the emphasis in the authorities was on the mode by which the property passed, not what became of the property after it had passed. He considered this latter point to be irrelevant.

In summary, case law shows that the elements required to be present in order for a disposition to exist are:

- A "disposition" and/or "disposing of" property must involve total alienation of that property by the disposer.

- Whether anything further must be established in terms of the ordinary meaning in a particular situation will depend on the context in which the concept is used, including whether the relevant statutory provision expressly extends the meaning - extending the meaning tends to suggest that the ordinary meaning is narrower.

- Generally, a disposition will involve the disposing of property that is already in existence at the time of the disposal.

- A disposition usually needs to be intended by the disposer and be something that the disposer is actively involved in, as opposed to being something unilaterally done by a third party. This is the notion of the disposer doing the alienating, rather than being passive and the disposee or some other party making the alienation occur.

- The requirement that there be some degree of "dealing with" the property being disposed of by the disposer is closely linked to the requirement that the property being disposed of must stay in existence following the disposal from one party to another. However, this does not seem to be an absolute requirement given that the courts have held that disposition may arise even though the disposal results in the extinguishment of the property.

To recap on the elements of a TTQ: a TTQ was created by virtue of section 28BA of the Fisheries Act 1983. This declared rock lobster to be subject to the quota management system for a period of 25 years from 1 April 1990.

The allocation of tonnages of rock lobster for TTQ was made primarily to those persons who already held licences to fish for rock lobster under the ITQ system using as a basis the proportion that the commercial catch of that person over the last 6 years bore in relation to the total commercial catch in that quota management area.

The QMS under Part II of the Act specifies the total allowable catch for all species of fish. Section 28CA states that the total allowable commercial catch for rock lobster is that which appears in the final column of the Second Schedule of the Maori Fisheries Act 1989. Section 28D provides that the Minister may vary the tonnages from time to time according to certain considerations.

As from 1 October 1996, TTQ are no longer in existence. Sections 28BA and 28EA of the Fisheries Act 1983 (which declared rock lobster subject to quota fishing and made provision for subsequent allocation) were repealed by section 314 of the Fisheries Amendment Act 1996 (No.88). In the same amendment, section 334 provided for the treatment of TTQ as a result of the change in legislation. It states that the conversion from TTQ to ITQ is not a new allocation.

Applying the criteria emanating from the case law above as being required in order for there to be a disposition of a TTQ:

- The conversion of a TTQ is not a total alienation of the rights or interests in that property. All of the rights or interests that existed under a TTQ remain undisturbed after the conversion to an ITQ, except that there has been a variation to the term, i.e. the number of years that the fishing quota is valid for.

- The rights or interests that existed under a TTQ are still the same rights or interests under an ITQ (i.e. the ability to catch or harvest a certain amount of rock lobster in a certain area), except that the term has changed, i.e. the quota no longer has an ending date. This is supported by the words in section 334(2) Fisheries Act 1996: "The conversion of quota by subsection (1) of this section does not constitute an allocation of new quota for the purposes of any enactment or rule of law".

- That a court is unlikely to extend the ordinary meaning of "disposition" unless clearly a number of requisite elements, in particular total alienation, could be satisfied.

- That the disposition (conversion) was not intended by the holder of such quota and the holder had no active involvement in its disposal. It is arguable that the holder, at the date of acquisition, was aware that a TTQ may have a limited life, but, in any event, it is not sustainable to argue that the purchaser of a TTQ would, ordinarily, have acquired that property with the purpose of resale. Ordinarily, a purchaser would have acquired a TTQ in order to catch rock lobster and, under the law prevailing at that time, this was the only means available.

- That the conversion of a TTQ to an ITQ by operation of law did not involve any activity or degree of "dealing with" the property on behalf of the holder of a TTQ.

As noted earlier, the wording of section 334(2) of the Fisheries Act 1996 also supports the view that the conversion is not a disposal, as it explicitly states that this conversion "is not a new allocation". This confirms that Parliament did not intend there to be an alienation on conversion. On this basis, the conversion of a TTQ to an ITQ does not constitute a "disposal" for the purposes of this provision [Fisheries Act 1983, subsection (2) - not a new allocation; subsection (4) - ITQ perpetual even though previously only for 25 years].

The conversion of a TTQ to an ITQ is not a "disposal" because it is not an event whereby the rights which constitute or are part of an item of intangible property mean that it will no longer be able to be exercised, at any time, by the taxpayer who owned that property. It is not necessary to consider whether the conversion of a TTQ would be excluded from the definition of "disposal" by virtue of such disposition being part of an arrangement to replace it with property of the same type.

In summary:

- A TTQ is an asset of a capital nature, and therefore the costs of acquisition and any profit or loss on the sale of a TTQ are of a capital nature and therefore not deductible.

- The cost of a TTQ is not deductible under section 104, and as the cost is not able to be amortised in terms of section 104A, no unexpired portion of the expenditure can be claimed on conversion of to an ITQ.

- A TTQ is a right to use land, as the courts have stated that the right to use or take from the water includes the land below such waters and, in addition to this, it may also be necessary to use the land in order to exercise the fishing rights.

- A TTQ is "depreciable property" within the meaning of Act pursuant to it being a "right to use land" within the 22nd Schedule. A TTQ acquired after 1 April 1993 can be depreciated from the date of acquisition up until 30 September 1996, in accordance with the formula in section 108G.

- The conversion of a TTQ to an ITQ is not a "disposal" within the definition provided for in the Act.

Effect on whether the conversion of a TTQ to an ITQ is a "disposal"

The effect of these conclusions is that the cost of a TTQ acquired after 1 April 1993 is able to be depreciated. However, this depreciation will cease as at 30 September 1996, being the date of the conversion to an ITQ. The conversion of a TTQ to an ITQ does not constitute a "disposal" in terms of section 117(10), and so any depreciation claimed in those prior years is not recoverable and there will be no gain or loss on conversion. No deduction of any kind is available for TTQ acquired prior to 1 April 1993, as TTQ were not included within "depreciable property".

Conclusions

The overall effect is that qualifying taxpayers are unable to deduct the cost of acquiring TTQ, and any gain or loss on conversion is not assessable. Those taxpayers are, however, able to claim depreciation for a maximum period of three and a half years, being 1 April 1993 to 30 September 1996. Any depreciation claimed is not recoverable by Inland Revenue at the date of conversion, as there is no disposal.