EASEMENTS—DEDUCTIBILITY OF THE COSTS OF PREPARATION, STAMPING, AND REGISTRATION

This interpretation statement sets out the Commissioner's view on the deductibility of expenditure incurred for the preparation, stamping, and registration of easements used in the derivation of the taxpayer's gross income—previously stated in Public Ruling BR Pub 98/7 *Easements – deductibility of costs of preparation, stamping, and registration*, published in the *Tax Information Bulletin* Vol. 10, No. 12 (December 1998). The ruling ceased to apply from 31 March 2002.

Public Ruling BR 98/7 has not been reissued as there is some doubt as to whether the arrangement to which the Ruling applied is an arrangement (as defined in the Act) for which a Public Ruling can be issued.

Summary

All legislative references are to the Income Tax Act 1994 unless otherwise stated.

This interpretation statement considers whether the expenditure incurred for the preparation, stamping, and registration of an easement used in the derivation of the taxpayer's gross income is deductible under s DJ 11.

Section DJ 11 applies as follows:

- An easement is a lease for the purposes of section DJ 11.

- The Commissioner will allow a deduction for costs incurred by a taxpayer in the preparation, stamping, and registration of easements where they are used in the derivation of the taxpayer's gross income, in the income year in which the expenditure is incurred.

- Payments made for the grant of an easement are not expenditure incurred in the preparation of an easement and therefore not deductible under s DJ 11.

Background

Land may have its utility enhanced by the right to the use of an easement. Once registered an easement gives an interest in the land that is of enduring benefit.

Under section DJ 11 a taxpayer is allowed a deduction for the costs of the preparation, stamping, and registration of "any lease of property used in the derivation of the taxpayer's gross income".

Issue

The issue is whether an easement is a "lease of property" as defined in the Act.

Legislation

Section DJ 11 states:

A taxpayer is allowed a deduction in respect of expenditure incurred by the taxpayer during an income year for the preparation, stamping, and registration of any lease of property used in the derivation of the taxpayer's gross income, of any renewal of any such lease, or in the borrowing of money employed by the taxpayer as capital in the derivation of gross income.

The following are defined terms in section OB 1:

"Estate" or **"interest",** in relation to land, means any estate or interest in land, whether legal or equitable, and whether vested or contingent, in possession, reversion or remainder; and includes any right to the possession of land or to receipt of the rents or profits from the land, or to the proceeds of the sale or other disposition of the land, whether immediate or through a trustee, or otherwise; but does not include a mortgage:

"Interest" –

…

(b) In relation to land, has the same meaning as **"estate"**

"Lease" –

(a) Except as provided in paragraphs (b), (d), (e), and (f) means a disposition that creates a leasehold estate:

"Leasehold estate" includes any estate however created, other than a freehold estate:

Analysis

The nature of an easement

The essential elements of an easement, as developed by common law, are that:

- there must be a dominant tenement and a servient tenement (*Hawkins v Rutter* [1892] 1 QB 668); and
- the easement must accommodate the dominant tenement such that it is related to the utility of the land and must do more than confer a personal benefit on the owner of the land (*Re Ellenborough Park* [1955] 3 All ER 667); and
- the dominant owner and servient owner must be different persons (*Metropolitan Rly Co v Fowler* [1892] 1 QB 165); and
- the easement must be capable of forming the subject matter of the grant (*Re Ellenborough Park*).

In New Zealand, the common law elements of an easement have been modified by statute. The statutory modification has created "easements in gross". Section 122 of the Property Law Act 1952 allows the creation of easements in gross. An easement in gross is one where there is no requirement for a dominant tenement. The right created by the easement is not appurtenant to another parcel of land. This modifies the first element of a common law easement, that there be a dominant and servient tenement.

While statute permits an easement where there is no dominant tenement, there must be a servient tenement. This is necessary, for if the right granted by the easement arises from ownership of the land, there is no requirement to claim that right as an easement as it already exists.

Two other features of an easement, while not defining characteristics, further describe the rights and limitations of an easement:

- An easement permanently binds the land over which the right is exercised, and similarly subsists permanently for the benefit of the dominant tenement. One issue that arises is whether the rule against perpetuities applies to an easement. If the right created by the easement vests immediately with the grantee, authority indicates that the rule against perpetuities does not apply (*Ellison v Vukicevic* (1986) 7 NSWLR 104).

- The notion that an easement cannot and does not confer a right to possession in the land over which the right is granted (*Copeland v Greenhalf* [1952] 1 All ER 809).

An easement is a lease for the purposes of the Act

Although an easement is not an estate in land, it is an interest in land as contemplated by the law of real property. In *Auckland City Council v Man O'War Station Limited* [1996] 3 NZLR 460, Anderson J observed:

> An easement… is an incorporeal hereditament, which is a right in respect of land, and therefore an **interest** in land, but it is not land in the tangible sense nor an **estate** in land in the common law sense. [page 465] [emphasis added]

An easement may be distinguished from other lesser rights such as a licence. A licence is a personal right and so does not pass an interest in the land in the way that an easement does (*Errington v Errington* [1952] 1 All ER 149 and *Thomas v Sorrell* (1673) 124 E.R. 1098).

A lease, as contemplated in the law of real property, is an estate of less than freehold. Estates of less than freehold exist where the duration of the estate is certain or capable of being made certain (*Charles Clay & Sons Ltd v British Railways Board* [1971] 1 All ER 1007). Adams EC (Ed) in *Garrow's Law of Real Property* (Butterworths, Wellington, 1961) categorises leases whether for a fixed term, at will, or at sufferance as the estates of less than freehold.

For the purposes of the Act, a "lease" is defined in section OB 1 as any disposition by which a "leasehold estate" is created. An easement is created by a disposition of property. The owner of the fee simple which will become the servient tenement surrenders, or disposes of, part of his or her right in the land to another person. Also implicit in the definition is that the disposition must **create** a leasehold estate. That is, the disposition must not be one that, for example, **transfers** the leasehold estate in the land. An easement qualifies, as it is not a transfer of any interest in the land but the creation of an interest in the land, a right that attaches to land so that it may improve its use and benefit.

"Leasehold estate" is also defined, as any estate however created, other than a freehold estate. The concept of a "freehold estate" was developed by common law. A freehold estate is one of uncertain duration: the feature that distinguishes it from an estate of less than freehold, i.e. a lease. In the case of individuals it is uncertain as it is measured by reference to their lives. For corporations, it is uncertain, as they may

continue on indefinitely. There are three types of freehold estates in New Zealand: the fee simple which will enure until the holder of the estate dies intestate without heirs, the life estate which will continue only for the life of the holder and is extinguished on that person's death, and the stratum estate created by section 4(2) of the Unit Titles Act 1972.

The term "estate", also defined in the Act, is coupled with the word "interest". "Interest" is defined as having in relation to land the same meaning as "estate". For the purposes of the Act, therefore, the terms "estate" or "interest" are merged and treated synonymously.

An easement is an interest in land. A lease is an estate in land. The term "lease" is the nomenclature used in the Act for estates or interest in land unless specifically excluded, such as estates of freehold and mortgages. An easement as an interest in land is therefore a "lease" as defined in the Act. Therefore s DJ 11 applies to the costs of preparation, stamping, and registration of easements.

Incurred expenditure allowable by the Commissioner

It is difficult to identify definitively the types of expenditure incurred in the preparation, stamping, and registration of easements. The costs incurred in the preparation, stamping, and registration of easements are not specified in the Act.

The Courts have not had occasion to consider the types of expenses that are incurred in the "preparation" of an easement in the context of s DJ 11. However, the word "preparation" or "prepare" has been considered judicially (*Horsley v Collier and Cartly Ltd* [1965] 2 All ER 423 and *Calabria v R* (1982) 151 CLR 671). Those cases point to the word "preparation" indicating something that is done prior to it being ready for its use.

Where the character of the expenditure is for the preparation, stamping, and registration of the easement and the easement is used in the derivation of the taxpayer's gross income, then the statutory requirement has been satisfied and a deduction permitted accordingly. It is not possible to provide an exhaustive list of preparation costs. However, an example of costs that will be allowed are legal costs, registration fees, and surveying costs.

Costs for granting of an easement not deductible

It is not uncommon for the owner of what will become the servient tenement to receive a sum of money for granting the easement. Payment for the granting of an easement is not part of the preparation expenses.

Preparation expenses are expenses incurred in the acts or instances of preparing an easement. Payments for the grant of an easement are payments made in consideration for the grant of an easement and are not expenses incurred in the process of preparing an easement. Payments made for the grant of an easement are not deductible under s DJ 11.

Example

Farmer Ltd is a company conducting its agricultural and horticultural activities in an area where rainfall is limited and there is no natural irrigation. Farmer Ltd arranges for irrigation to be provided to the property. This requires reticulation across a neighbouring property. Farmer Ltd incurs survey costs and legal fees in the preparation, stamping, and registration of the easement allowing the diverted water to be transported to Farmer Ltd's property. Farmer Ltd agrees to pay the owner of the neighbouring property a one-off lump sum payment for the **right** to create the easement. In addition, the owner of the dominant tenement, Farmer Ltd, agrees to pay the legal costs for reviewing and approving the drafted easement's documentation incurred by the owner of the neighbouring property, i.e. the owner of the servient tenement.

The survey costs and legal fees, including those paid for the owner of the neighbouring property, are costs for the preparation, stamping, and registration of the easement and so are deductible in the income year in which they are incurred. The cost of the irrigation scheme itself is not part of the costs of preparation, stamping, and registration of the easement. The one-off payment to the owner of the neighbouring property for the **right** to create the easement is not for the preparation, stamping, and registration of the easement and therefore is not deductible.