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TAX INFORMATION Bulletin

CONTENTS

Inland Revenue
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YOUR OPPORTUNITY TO COMMENT

Inland Revenue regularly produces a number of statements and rulings aimed at explaining how taxation law affects taxpayers and their agents. Because we are keen to produce items that accurately and fairly reflect taxation legislation and are useful in practical situations, your input into the process, as a user of that legislation, is highly valued.

You can find a list of the items we are currently inviting submissions on as well as a list of expired items at **www.ird.govt.nz/public-consultation**

Email your submissions to us at **public.consultation@ird.govt.nz** or post them to:

Public Consultation
Office of the Chief Tax Counsel
Inland Revenue
PO Box 2198
Wellington 6140

You can also subscribe at **www.ird.govt.nz/public-consultation** to receive regular email updates when we publish new draft items for comment.

IN SUMMARY

IN SUMMARY (continued)

The Commissioner applied to strike out the application for judicial review on the basis the Court had no jurisdiction to hear most of the complaint, and even if there was jurisdiction, the statement of claim did not disclose an arguable cause of action and was an abuse of process.

The Court found for the Commissioner and struck out the proceeding for lack of jurisdiction. The Court also noted that if it was wrong in that conclusion, the statement of claim disclosed no arguable cause of action and struck it out on that basis.

Parents' payments to private school were not unconditional gifts, but were consideration for the supply of education services and subject to GST 56

The disputant challenged the assessments for goods and services tax ("GST") made by the Commissioner of Inland Revenue ("the Commissioner") for the seven six-monthly GST periods. The disputant argued it was not liable to pay output GST on payments made by parents at one of their schools, as those payments were charitable donations and therefore were unconditional gifts. However, the Commissioner argued those payments were consideration for the provision of education services by the disputant and therefore liable for output GST. The Taxation Review Authority ("the Authority") found in favour of the Commissioner.

Accountant loses appeal in High Court for expenditure on rental properties and treatment of trust income and expenses 58

This decision concerns the appellant taxpayer's (Mr Wong) appeal against the Taxation Review Authority's ("the Authority") decision upholding the Commissioner of Inland Revenue's ("the Commissioner") assessments in the 2013 and 2014 income years (*TRA Case 09/16* [2017] NZTRA 04). The Commissioner disallowed interest and other expenditure on funds borrowed to purchase properties for commercial rental having the effect of increasing Mr Wong's taxable income. The High Court was not satisfied that Mr Wong had discharged his onus of showing how and by how much the Commissioner's assessments were wrong ultimately finding the Authority's decision correct in all respects and disallowing the appeal.

BINDING RULINGS

This section of the *TIB* contains binding rulings that the Commissioner of Inland Revenue has issued recently. The Commissioner can issue binding rulings in certain situations. Inland Revenue is bound to follow such a ruling if a taxpayer to whom the ruling applies calculates their tax liability based on it.

For full details of how binding rulings work, see *Binding rulings: How to get certainty on the tax position of your transaction (IR715)*. You can download this publication free from our website at **www.ird.govt.nz**

Product Ruling – BR Prd 18/04: Harbour Fund III G.P. Limited

This is a product ruling made under s 91F of the Tax Administration Act 1994.

Name of the Person who applied for the Ruling

This Ruling has been applied for by Harbour Fund III G.P. Limited.

Taxation Laws

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Ruling applies in respect of ss BD 1(4), BD 1(5), BG 1 and YA 1.

The Arrangement to which this Ruling applies

The Arrangement is the receipt by Harbour Fund III LP (the Fund) of proceeds (Proceeds) under individual funding agreements that the Fund will enter into with litigation claimants (the Claimants) in a proposed class action against Steel & Tube New Zealand Limited and/or Steel & Tube Holdings Limited (Steel & Tube) (and possibly other steel manufacturing companies) under which the Fund will agree to pay all legal and other costs incurred by the Claimants in return for a share of the Proceeds.

Further details of the Arrangement are set out in the paragraphs below.

The offshore parties to the Arrangement

1. The Fund is a limited partnership registered in the Cayman Islands and has been established to make litigation and arbitration funding available for all types of claims other than personal injury, divorce or defamation proceedings. The Fund is not a trustee of a trust.
2. Under the law of Cayman Islands, the Fund does not have separate legal personality from its partners (Limited Partners). The Fund is not the beneficial owner of its assets, which are held by Harbour Fund III GP Limited (the General Partner), in accordance with the terms of the Fund's limited partnership agreement.
3. The Fund provides funding for litigation claimants all around the world who have met certain criteria. The criteria include the creditworthiness of the defendant, the legal merits of the case, the expertise of the legal team and the likely legal fees.
4. The Fund is advised by Harbour Litigation Cayman Limited (the Investment Advisor) a company incorporated in the Cayman Islands. The Investment Advisor has been contracted by the General Partner under an investment advisory agreement (Investment Advisory Agreement) to perform investigation, evaluation and due diligence services in respect of potential claims for which funding is sought.
5. Preliminary investigation and due diligence services have in turn been subcontracted by the Investment Advisor to Harbour Litigation Funding Limited (the Sub-Advisor) which is a company incorporated in England and Wales, under a sub-advisory agreement (Sub-Advisory Agreement).
6. Details of the activities undertaken by the Investment Advisor and by the Sub-Advisor (together the Advisors) when investigating and evaluating potential claims are set out below.

Summary of the normal investment procedures

7. The Advisors ensure that the business of the Fund is known to interested parties. However, the Advisors do not actively or routinely seek to identify and locate specific claims for which funding might be provided.
8. Once a request for funding is received a confidentiality agreement is entered into, and the Advisors conduct a preliminary assessment. Information is gathered regarding the claim, and an immediate analysis is conducted to assess whether the claim is likely to satisfy the Fund's criteria. If the claim is unlikely to satisfy the criteria, it will generally be rejected at this stage.

9. If a claim passes the first stage of analysis, the Sub-Advisor will, if appropriate, enter into a letter of intent, usually with the claimant directly, but in the case of a class/group action, with the legal representative seeking funding on behalf of the claimants. This procedure has been adopted because there are too many claimants to execute separate documents with and they may not yet have been identified. The Sub-Advisor will then conduct a more detailed due diligence to ascertain whether the claim would be likely to meet the criteria for funding.
10. An Investment Committee established by the Investment Advisor then meets every few weeks to evaluate the legal merits of the cases for which funding is sought which satisfy the Fund's criteria. The Investment Committee also receives updates on the progress of existing funded claims.
11. At the conclusion of each meeting the Investment Committee, where appropriate, make a formal recommendation to the Board of the Investment Advisor, about investing in proposed new claims. The Investment Committee also reports to the Board of the Investment Advisor on existing funded claims if there have been material adverse developments in the case of existing funded claims.
12. The Board of the Investment Advisor then considers the recommendations made by the Investment Committee at its monthly meeting. Where the Board of the Investment Advisor considers that a proposed claim is likely to meet the Fund's criteria for funding, a recommendation is made by the Board of the Investment Advisor to the Board of the General Partner, which has the authority to invest in claims on behalf of the Fund.
13. The Board of the General Partner then meets to consider the recommendations made by the Board of the Investment Advisor.
14. Where the Board of the General Partner (on behalf of the Fund) considers that a recommended claim is meritorious, the Fund will make funds directly available for the claim by entering into a funding agreement or funding agreements with the claimants.

How the decision to fund this Claim was made

15. The Sub-Advisor was approached in June 2016, via email, by Adina Thorn of Adina Thorn Lawyers, in relation to the possible funding of a representative action in relation to the quality of seismic mesh and the supply of non-compliant seismic mesh for use in building construction, predominantly in and around Christchurch. The potential claim, would be based in negligence and breach of statutory duties, and was expected to involve over 317 Claimants with a claim for damages in excess of NZ$44 million (the Claim). This matter was the subject of an investigation and subsequent prosecution by the Commerce Commission.
16. In accordance with the normal procedure summarised above, this approach for funding was subjected to the preliminary review and assessment process. It was subsequently concluded that the Claim could potentially satisfy the Fund's criteria.
17. Due diligence was then undertaken by the Advisors, and ultimately a recommendation was made to the Board of the General Partner that the Claim be approved for funding.
18. At its July 2017 meeting in the Cayman Islands, the Board of the General Partner approved the Claim for funding.
19. The parties then attended to the finalisation of anticipated timetables and funding amounts, and appropriate documentation was prepared for the Fund to record the terms on which funding would be provided to Claimants.
20. A draft of the funding agreement (Funding Agreement) was prepared, to record the terms on which the Fund will make funding available to Claimants for their legal and other costs incurred in relation to the Claim. A draft relationship agreement (Relationship Agreement) was prepared to record the various invoicing and reporting requirements that will apply to the legal representative (Legal Representative) acting for the funded Claimants throughout the proceedings (Proceedings).
21. The Relationship Agreement was finalised and entered into on 2 August 2016 by the Board of the General Partner and the Legal Representative. At the date that this Ruling is signed Adina Thorn Lawyers are the Legal Representative, but the Claimants have the ability to appoint a replacement Legal Representative. The Funding Agreement was finalised by 29 June 2018 with Claimants progressively entering into the Funding Agreement from that time.

Funding Agreement

22. The Funding Agreement records the terms on which the Fund agrees to make funds available to Claimants (ie, individuals or groups who have suffered damage within the scope of the Claim) for the "Claimant's legal costs" (Claimant's Legal Costs). The phrase Claimant's Legal Costs is defined in cl 20.1 of the Funding Agreement. It includes legal fees incurred in relation to the Claim, and any costs incurred by the Claimants (subject to certain exclusions) should the Claimants be ordered to pay the legal costs of the defendant or any other party involved in the Claim. Under the terms of cl 9 of the Funding Agreement the Claimants have agreed that in the event that the Claimants are successful, the Fund will receive the Proceeds.

23. The Claimants will comprise individuals, groups of individuals and companies (or their respective representatives, such as liquidators or administrators) that are home and building owners, affected by defects in the design and/or manufacture of seismic mesh used in their homes and buildings.

24. Virtually all of the Claimant group is located in New Zealand, and all of the properties to which the Claim relates are located in New Zealand. This Ruling only considers or rules on the Arrangement to the extent it relates to New Zealand properties.

Funding process

25. Funding for the Claimants Legal Costs will be made available under the Funding Agreement in two stages. The first stage comprises the point up to which all the pre-conditions for full funding are satisfied, and a statement of claim has been filed.

26. The Applicant advised that due to the process of confirming Claimants taking time, Claimants will be confirmed as being part of the Claimant group on a progressive basis during the first stage of funding. Claimants will continue to be confirmed up until (and potentially after) the time that the statement of claim is filed. It is possible that Claimants could be confirmed and enter into the Funding Agreement after the second stage of funding has commenced.

27. During the first stage, legal fees will be incurred for work which will benefit all Claimants including Claimants who are accepted towards the end of the first stage. The definition of Claimants Legal Costs (cl 20.1 of the Funding Agreement) overcomes a potential problem associated with the timing of, and allocation of, legal costs, which were incurred before a Claimant entered into the Funding Agreement. This clause provides that Claimants will agree that each Claimant's proportionate share will be allocated by reference to the value of their claim, regardless of when each Claimant entered into the Funding Agreement.

28. Provided that the Claim satisfies the preconditions for full funding, the Fund will, after the completion of the first stage, fund the second stage of the Claim. Funding will be provided for the second stage of the Claim until such time as the Fund terminates its obligations under the Funding Agreements or the Proceedings are concluded (whether by settlement or judgment of the courts).

Fund's entitlement to Proceeds

29. In the event that the Fund funds stage one and two of the Claim, and the Claim is successful, the Fund will be entitled to receive the Proceeds. The amount of the Proceeds will be calculated on the basis set out in the Funding Agreement. Clause 9.1(a)(i) to (vi) outlines how the Proceeds will be allocated between the Fund and the Claimants.

30. In accordance with the Funding Agreement, the Legal Representative will receive and hold any damages, costs and settlement sums received in respect of a Claim on bare trust for the Fund and the Claimants in the proportions agreed until such time as the relevant amounts are paid to the Fund and to the Claimants. All amounts received from the defendant must first be paid to the Fund who will be paid in priority to the Claimants, who shall each receive such sum as is equal to their share of the remaining damages, costs or settlement sum.

Control of Claim

31. Control of the Claim will rest with the Claimants. The Fund will have no ability to instruct the Legal Representative or dictate how the Proceedings are to be conducted. Clause 5 of The Funding Agreement expressly acknowledges that the Fund has no control over or right to make decisions about the Proceedings. Only the Claimants, through the Representative Claimant (Representative Claimant) may instruct the Legal Representative and determine, for example, the claims that will be pursued and what actions will be taken or decisions made on a day to day basis in respect of the conduct of the Proceedings.

32. Clause 6.1(e) of the Funding Agreement provides that at any time Claimants will be entitled to change the Legal Representative. While the prior written agreement of the Fund is required, this clause provides that the Fund's consent to such a change is not to be unreasonably withheld. However, in order to continue to receive funding under the Funding Agreement, the Claimants will be required to ensure that the new Legal Representative executes a deed in favour of the Fund under which the new Legal Representative agrees to be bound by the terms of the Relationship Agreement as if they were the prior Legal Representative.

33. Clauses 5, 6 and 13 of the Funding Agreement outline the Claimants obligations under the Funding Agreement. They include taking certain actions and to provide certain instructions to the Legal Representative in relation to certain anticipated future events including: in relation to the pursuit of an appeal should the Fund wish to provide funding for an appeal, and in relation to settlement decisions should settlement be recommended or not recommended (as the case may be) by the Legal Representative.

34. The Applicant states that because this is a class action, Claimants will also agree on entering into the Funding Agreement the manner in which the Proceedings will be conducted and the Representative Claimant will instruct the Legal Representative. This is to ensure that the funded Claimants agree at the outset how the Proceedings will be conducted, and so that the Fund can be confident that the Proceedings are being conducted in an optimal manner.

Termination

35. Clause 1 of the Funding Agreement contains an initial cooling off period of 20 days. Clause 12 of the Funding Agreement provides that a Claimant will not be able to unilaterally terminate its obligations under the Funding Agreement. Claimants will only be entitled to actively terminate their obligations if there has been a material breach by the Fund which has adversely affected the Claimant's interests and which has not been remedied by the Fund within 30 days.

36. Clause 12 of the Funding Agreement enables a Claimant to opt out of the class action if the Claimant gives instructions to the Legal representative or otherwise exercises a right to opt out of the Proceedings. However, if the Claim is subsequently successful the Fund is still entitled to recover its share of the Proceeds as if the Claimant had not opted out of the class action.

37. Clause 11 of the Funding Agreement provides that the Fund will have the right at any time to terminate its obligation to contribute to future legal costs in respect of the Claim.

Key contractual terms relating to process

38. Claimants will agree to take certain actions and provide certain instructions to the Legal Representative in relation to the manner in which the Proceedings will be conducted, and in relation to certain potential future events. These obligations are contained in the following clauses of the Funding Agreement:

- Clause 5: Conduct of Proceedings.
- Clause 6: Claimant's Obligations.
- Clause 9: Application of Proceeds and Interim Recoveries.
- Clause 13: Settlement Decisions.
- Clause 19: General Provisions.

39. Under cls 5, 6 and 13 of the Funding Agreement, each Claimant will agree:

- That the Representative Claimant will determine, in consultation with the Legal Representative and without direction from the Fund, what claims will be pursued (cl 5.1(a)).
- That the Representative Claimant will, without direction from the Fund, give day to day instructions to the Legal Representative and will make binding decisions on behalf of Claimants (cl 5.1(c)).
- That the Claimant will provide all information and documents required by the Legal Representative, will deal promptly with all requests made by the Legal Representative and will co-operate generally with the Legal Representative (cls 6.1(m) to 6.1(o)).
- That the Claimant will act reasonably and commercially in the prosecution of the Proceedings and in accordance with the advice of the Legal Representative (cl 6.1(d)).
- That the Claimant will accept and follow the Legal Representative's reasonable legal advice including advice in relation to settlement (cl 6.1(i)).
- That the Representative Claimant is authorised to make or take any action constituting a settlement decision provided that the Legal Representative has advised such action is reasonable (cl 13.1).
- That the Legal Representative is authorised to and instructed to accept on the Claimant's behalf, any settlement proposed where the Claimant has not initially wanted to act in accordance with the advice of the Legal Representative and the matter has been referred to independent counsel for opinion, with the independent counsel having recommended that the Legal Representative's advice is reasonable in all the circumstances (cls 13.3 and 13.4).

40. In addition, each Claimant will agree under the Funding Agreement that the Fund is entitled to communicate directly with the Legal Representative, and that the Fund is entitled to receive any information which has or may have a material impact on the Claim and/or the Proceedings (cls 5.1(d) and 6.1(b)).

The Relationship Agreement between the Legal Representative and the Fund

41. The terms and conditions in the Relationship Agreement are consistent with the above provisions in the Funding Agreement. The Relationship Agreement provides that the Legal Representative must:

- Act consistently with all authorisations and instructions given by the Claimant as contemplated in the Funding Agreement, subject to having received such instructions or authorisations (cl 2.4).
- Only enter into a "Retainer" (as that term is defined in the Relationship Agreement) with a Claimant if the Claimant gives the Legal Representative all the authorisations and instructions contemplated and referred to in the Funding Agreement (cl 2.5).
- Ensure the Claimant is given all necessary information to facilitate informed instructions (cl 8.2).
- Keep the Fund fully informed by providing a monthly report in the form set out in the Relationship Agreement (cl 8.1(b)) and until Proceedings are issued provide a fortnightly report in relation to the progress of the book build and other matters (cl 8.1(a)).
- Give the Fund access to, and when requested provide the Fund with copies of, all material documents produced by or for the Claimants in relation to the Proceedings (cl 8.1(c)).
- Immediately inform the Claimant, and in accordance with the Claimant's instructions as contemplated in the Retainer and the Funding Agreement, notify the Fund if the Legal Representative becomes aware of any information which has or may have a material impact on the Claim (cl 8.2(b)).
- Immediately notify the Fund in the event that the Claimant receives a settlement offer, and prepare for the Claimant a written recommendation on whether to accept such an offer and provide a copy of that recommendation to the Fund (cl 8.1(f)).

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) None of the General Partner, the Limited Partners of the Fund, nor the Investment Advisor or Sub-Advisor is resident in New Zealand for income tax purposes.

b) None of the General Partner (whether on its own account or on behalf of the Fund), the Investment Advisor or Sub-Advisor own or lease any property located in New Zealand.

c) None of the General Partner (whether on its own account or on behalf of the Fund), the Investment Advisor or Sub-Advisor has any employees based in New Zealand.

How the Taxation Laws apply to the Arrangement

Subject in all respects to any condition stated above, the Taxation Laws apply to the Arrangement as follows:

a) Amounts received by the Fund and the Limited Partners under the Arrangement are "non-residents' foreign-sourced income" under s BD 1(4).

b) Amounts received by the Fund and the Limited Partners under the Arrangement are not assessable income under s BD 1(5).

c) Amounts received by the Fund and the Limited Partners under the Arrangement are not "interest" as defined in s YA 1.

d) Section BG 1 does not apply to the Arrangement.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 19 September 2018 and ending on 18 September 2023.

This Ruling is signed by me on the 19th day of September 2018.

Howard Davis
Director (Taxpayer Rulings)

Product Ruling – BR Prd 18/05: PGG Wrightson Limited

This is a product ruling made under s 91F of the Tax Administration Act 1994.

Name of the person who applied for the Ruling

This ruling has been applied for by PGG Wrightson Limited (PGW), a member of the Wrightson Consolidated Group.

Taxation laws

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This ruling applies in respect of subpart CD, in particular, section CD 22 (returns of capital: off-market share cancellations).

The Arrangement to which this ruling applies

The Arrangement is the return of excess capital in PGW to its shareholders by way of an off-market, pro rata repurchase and cancellation of PGW shares, following the sale of 100% of the shares in PGW's subsidiary, PGG Wrightson Seeds Holdings Limited.

The share cancellation shall occur by either:

- an offer to acquire and cancel a pro rata portion of all shareholders' shares pursuant to section 60 of the Companies Act 1993; or
- a cancellation of a pro rata portion of all shareholders' shares (which will apply by default to all shareholders), such cancellation having been approved by shareholders and the court as required under Part 15 of the Companies Act 1993.

PGW has only one class of shares on issue, being ordinary shares. The amount of available subscribed capital attributed to the PGW shares has been determined and is set out in the factual review letter dated 28 September 2018.

The share cancellation will be conducted by PGW undertaking a two for one share split with the available subscribed capital remaining constant as part of the Arrangement (with the additional share then being the share that is cancelled). The cash distribution to shareholders will be entirely funded from the capital proceeds received from the sale.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

- All PGW shares cancelled as part of the Arrangement will be ordinary shares of the same class issued by PGW and the shares will be cancelled in whole, not part.
- The cancellation is either:
  - a pro rata cancellation offer to all of PGW's shareholders at the date PGW first gives notice to its shareholders of the offer, which, if accepted by each shareholder in full, would not alter any person's voting interest in PGW; or
  - a pro rata cancellation of shares that does not alter any person's voting interest in PGW.
- A market value circumstance will not exist at the time of the share cancellation.
- The total amount paid in consideration for the share cancellation will be 15% or greater of the market value of the ordinary shares at the time of PGW's first notice to shareholders of the pro rata share cancellation.
- Any changes to PGW's existing dividend policy will be unrelated to the share cancellation and cash consideration paid to the shareholders under the Arrangement.
- Any future issues of ordinary shares in PGW will be for genuine commercial reasons and will be unrelated to the share cancellation that is the subject of this ruling.

How the taxation law applies to the Arrangement

Subject in all respects to the conditions stated above, the taxation law applies to the Arrangement as follows:

- The amount distributed to PGW shareholders on the off-market pro rata share cancellation by PGW is not a dividend because section CD 22 applies to the extent that the amount paid per share is less than or equal to the available subscribed capital per share calculated in accordance with section 23(1).
- Section CD 22(6) does not apply to the Arrangement.

The period or income year for which this ruling applies

This ruling will apply for the period beginning on 30 October 2018 and ending on 31 October 2021.

This ruling is signed by me on the 12th day of October 2018.

Tracey Lloyd
Group Lead, Customer Compliance – Significant Enterprises

INTERPRETATION STATEMENTS

This section of the *TIB* contains interpretation statements issued by the Commissioner of Inland Revenue.

These statements set out the Commissioner's view on how the law applies to a particular set of circumstances when it is either not possible or not appropriate to issue a binding public ruling.

In most cases Inland Revenue will assess taxpayers in line with the following interpretation statements. However, our statutory duty is to make correct assessments, so we may not necessarily assess taxpayers on the basis of earlier advice if at the time of the assessment we consider that the earlier advice is not consistent with the law.

IS 18/06: Income tax – treatment of costs of resource consents

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

Overview

1. The ability to deduct or depreciate expenditure on a resource consent depends on the type of expenditure, the type of consent and the resulting asset. Different types of expenditure can be incurred on a resource consent. This Interpretation Statement focuses on expenditure that is the "cost" of a resource consent.
2. The Resource Management Act 1991 (RMA) places a number of restrictions on the way people can use land and resources. Resource consents granted by a consenting authority (usually the local or regional council) remove these restrictions. Various types of resource consents can be obtained under the RMA. However, for tax purposes the Act recognises two categories of resource consents, which this statement refers to as:
   - "environmental" consents; and
   - "land" consents.
3. Environmental consents are consents granted under ss 12–15 of the RMA (excluding reclamation consents) and listed in sch 14 of the Act as items of depreciable intangible property. These consents broadly concern resources and the environment.
4. Land consents broadly concern activities on land and are granted under ss 9 and 11 of the RMA (including reclamation consents). These are not included in sch 14.
5. This statement discusses whether deductions for the expenditure incurred in obtaining environmental and land consents are available and on what basis. The tax treatment depends on the particular facts and not all expenditure can be deducted or otherwise depreciated. This statement addresses deductibility of expenditure on resource consents in the following order:
   - Expenditure that is feasibility expenditure (see [107]–[111]);
   - Expenditure on revenue account (see [112]–[117]);
   - Expenditure that is deductible under a specific provision of the Act:
     - s DB 19 ([119]–[122]) for expenditure incurred in unsuccessful consents;
     - s DB 46 ([123]–[129]) for expenditure in controlling pollution;
   - Expenditure that is capital in nature that may give rise to depreciation:
     - Environmental consents can be depreciable intangible property (see [131]–[154]);
     - Capital expenditure on some land consents might be depreciable in two ways. Firstly, a land consent may be depreciable as an item of depreciable intangible property. The Commissioner considers that this would be rare. Secondly, and more commonly, expenditure on some land consents may be capitalised into the cost base of another item of property and potentially depreciated (although there is no depreciation deduction for land, and buildings with an estimated useful life (EUL) of 50 years or more depreciate at 0%). See [176]–[194].
6. The ways expenditure on resource consents may be deductible are summarised in the flowcharts following paragraph [105]. Flowchart 1 is for environmental consents and Flowchart 2 covers land consents. Because the tax treatment is so fact-specific, taxpayers can use the flowcharts to identify the parts of the statement that are most relevant to their situation.

Summary

7. This statement considers the tax treatment of the costs of obtaining a resource consent. The ability to deduct or depreciate expenditure on a resource consent depends on the type of expenditure and the type of consent. It is necessary to understand the different types of resource consents for tax purposes and to be able to identify what expenditure is included in the cost base of the resource consent (or another asset) for depreciation purposes. These key concepts and a discussion of *Trustpower Limited v CIR* [2016] NZSC 91 are covered in **Part One** of this statement.

8. The tax treatment varies depending on the circumstances and **Part Two** of this statement considers the specific situations in which expenditure on resource consents may be deductible or depreciable.

Summary – Part One

The different types of resource consent

9. The RMA places a number of restrictions on the way people can use land and resources. Various types of resource consents can be obtained under the RMA to remove these restrictions. However, for tax purposes the Act recognises two categories of resource consents, which this statement refers to as:
    - "environmental" consents – that broadly concern the environment and are granted under ss 12–15 of the RMA (excluding reclamation consents) and are listed in sch 14(10); and
    - "land" consents – that broadly concern land and are granted under ss 9 or 11 of the RMA (or are a reclamation consent) and are not listed in sch 14(10).

10. The different natures of the consents affect the tax treatment of the expenditure. In terms of depreciation, environmental consents are items of depreciable intangible property and the expenditure that forms the cost base can be depreciated over the fixed term of the consent. Land consents are generally of unlimited duration and will not usually be depreciable property. Expenditure on land consents can usually only be depreciated to the extent that the expenditure can be capitalised into the cost of another item of depreciable property. No depreciation deduction is available for any expenditure capitalised into the cost base of:
    - land; or
    - buildings (with an EUL of 50 years or more).

Identifying "cost" for a resource consent

Determining the cost base of a resource consent

11. Working out the amount of expenditure on a resource consent that is depreciable involves identifying the "cost" in s EE 16. Relevant is s EE 16(4)(b)(ii), which says the cost is the cost to the person, excluding expenditure that can be deducted under another provision of the Act. Accordingly, the following are excluded from being a "cost" of a resource consent for depreciation purposes:
    - Expenditure that is revenue in nature and deductible on that basis.
    - Expenditure that is deductible under the principles in IS 17/01: "Income tax – deductibility of feasibility expenditure" (*Tax Information Bulletin* Vol 29, No 3, April 2017) (referred to as IS 17/01 in this statement).
    - Expenditure otherwise deductible under a specific provision (examples may include legal fees deductible under s DB 62 and land leasing costs deductible under s DB 18).

12. The legislation is of limited assistance in identifying cost but a number of cases have considered the meaning of cost. The Court of Appeal adopted the *Shorter Oxford English Dictionary* definition, being "that which must be given in order to acquire something" (*Tasman Forestry Limited v CIR* (1999) 19 NZTC 15,147 and similarly *Wilke v CIR* (1998) 18 NZTC 13,923). The Court also considered that transactions should be viewed in their commercial reality and that "cost" has a wider meaning than payment on purchase. For the purposes of the depreciation rules, cost includes the set-up and installation costs of an asset (*BP Refinery (Kwinana) Ltd v FCT* 8 AITR 113). However, cost is fixed at the point the asset is ready to use. The exceptions to this are subsequent costs that can be added to the cost base of property under ss EE 18, EE 19 and EE 37.

13. Where "cost" is unclear, courts have derived assistance from common business parlance and practice, as well as accepted accountancy practice (*CIR v Atlas Copco (NZ) Ltd* (1990) 12 NZTC 7,327 and *BP Refinery*). Relevant to resource consents are accounting standards NZ IAS 16 and NZ IAS 38. Both include the same principle that for expenditure to be part of the cost, it must be directly attributable to bringing the asset to the location and condition necessary for it to be capable of

operating. The accounting standards also suggest that something as integral to the construction of an asset as a resource consent should be capitalised into the cost of the asset for accounting purposes.

14. The types of expenditure incurred in obtaining a resource consent will vary greatly from case to case and what is a "cost" of a resource consent will ultimately be a question of fact. The different meanings of "cost" depending on the context and the factual circumstances make it impossible to cover what the "cost" will be in each situation. This statement focuses on expenditure on resource consents and provides general principles to assist taxpayers in identifying whether expenditure forms part of the cost base of a resource consent depreciable under sch 14 or part of the cost base of other depreciable property.

Trustpower v CIR

15. *Trustpower* is the leading authority concerning some aspects of the tax treatment of expenditure on resource consents. The Commissioner considers that *Trustpower* supports the view that:
    - Resource consent expenditure is usually on capital account.
    - There is limited scope for feasibility expenditure in the context of applying for a resource consent.
    - Consents within sch 14 (ie, environmental consents) are depreciable intangible property. This means that capital expenditure that is a cost of the property can be depreciated over the fixed life of the consent.
    - Sometimes expenditure on resource consents will be part of the cost of other property, which may be depreciable property.

Summary – Part Two

16. Having discussed the concepts in Part One of the statement, Part Two considers the situations in which expenditure on resource consents may be deductible or depreciable.

17. The tax treatment of a particular consent depends on the facts and not all expenditure will be able to be deducted or otherwise depreciated. Part Two follows the structure of the two flowcharts (one flowchart addresses environmental consents and one flowchart addresses land consents) and addresses deductibility of expenditure on resource consents in the following order:
    - Expenditure that is deductible under the principles in IS 17/01.
    - Expenditure that is revenue in nature.
    - Expenditure that is deductible under a specific provision of the Act, in particular:
        - s DB 19 for expenditure incurred in unsuccessful consents;
        - s DB 46 for expenditure in controlling pollution.
    - Capital expenditure on environmental consents will be depreciable if the environmental consent is depreciable intangible property.
    - Capital expenditure on land consents might be depreciable in two ways. Firstly, a land consent may be depreciable as an item of depreciable intangible property. The Commissioner considers that this would be rare. Secondly, and more commonly, expenditure on some land consents may be capitalised into the cost base of another item of property and potentially depreciated (although there is no depreciation deduction for land, and buildings with an EUL of 50 years or more depreciate at 0%).

18. The deductibility of expenditure is subject to the general permission under s DA 1(1). For resource consent expenditure to be either deductible or depreciable, a sufficient relationship or nexus must exist between the expenditure and the taxpayer's business or income-earning activity. Whether a business or an income-earning activity is being carried on is always a question of fact and degree. For some taxpayers, resource consent expenditure will not be deductible or depreciable because it will have been incurred preliminary to, or preparatory to, the commencement of a business or income-earning activity. Deciding when a taxpayer ceases incurring expenditure that is preliminary or preparatory to the commencement of a business or an income-earning activity and commences incurring expenditure during the course or conduct of a business or an income-earning activity is often difficult to determine. The principles to apply to determine when a business or income-earning activity commences are discussed in more detail at paragraphs [29]–[98] of IS 17/01.

19. Also, any expenditure on resource consents for private purposes will not satisfy s DA 1 (or s EE 6) as the expenditure will not be incurred in deriving assessable income (and will also be denied by the private limitation in s DA 2(2)).

Feasibility expenditure deductible under the principles in IS 17/01 and Trustpower

20. The Commissioner has previously set out her views on the deductibility of what might be labelled "feasibility expenditure" in IS 17/01: "Income tax – deductibility of feasibility expenditure". To the extent that taxpayers have incurred such expenditure they should refer to the principles in IS 17/01 and *Trustpower*. The Supreme Court in *Trustpower* considered that expenditure associated with early stage feasibility assessments may be deductible but this does not extend to costs incurred with the intention of materially advancing the capital project in question. When it comes to applying for a particular resource consent, the expenditure will often be directed to a specific capital asset or towards making tangible progress on a specific capital asset. If that is the case, then the expenditure will not be deductible under the principles in IS 17/01 and *Trustpower*.

Revenue expenditure

21. Applying the principles in *Trustpower*, the Commissioner considers that resource consents will generally be capital in nature because resource consents will usually relate to the business structure and provide an enduring advantage. Although usually capital in nature, the Supreme Court in *Trustpower* recognised that in some cases expenditure associated with resource consents could be revenue in nature. The example provided by the Supreme Court was where the resource consent forms part of the stock-in-trade of a land-developer/speculator. In this case the costs of obtaining the consent are on revenue account and deductible under s DA 1 and s DB 23 (under s DB 23 special timing provisions apply).

Deductions under specific provisions of the Act

22. Deductions are also available under certain specific provisions in the Act, for instance s DB 62 allows a deduction for legal expenses under $10,000. Also, some types of expenditure, such as petroleum mining expenditure and mineral mining expenditure, have their own regimes.

23. This statement focuses specifically on ss DB 19 and DB 46 as they are the most relevant to resource consents. Section DB 19 allows a deduction (for what would otherwise be "black hole" expenditure) where money is spent on a consent but the consent is never granted or used. However, a deduction is only allowed to the extent that the expenditure would have been deductible or depreciable had the consent been granted or used. If the expenditure was a cost of an environmental consent it is likely to be deductible under s DB 19. This is because the expenditure would have been depreciable as the cost of an item of depreciable intangible property. For expenditure on a land consent, it depends on the depreciation outcome. To be deductible under s DB 19, the expenditure must be able to be capitalised to an item of depreciable property and be depreciable.

24. Section DB 46 provides a deduction for expenditure incurred in pollution control. To qualify under s DB 46, the expenditure must be listed in parts A and B of sch 19 and not otherwise deductible under another provision in the Act. Practically, this leaves limited scope for a deduction for resource consent expenditure, but an example of where this may arise is where a land consent is obtained for earthworks to remove contaminated soil.

Environmental consents depreciable as depreciable intangible property

25. If the expenditure is not deductible under another provision it may be able to be depreciated as a cost of depreciable property. Section EE 1 sets out when a person has an amount of depreciation loss and requires that the person owns the depreciable property and it is used or available for use by the person. Assuming that is the case, s EE 6 defines depreciable property as property that might reasonably be expected to decline in value while available for use in deriving assessable income. The nexus requirement is discussed above in the context of s DA 1, but it is important to note that there is no deduction where the resource consent is obtained for private purposes or prior to the commencement of the business or income-earning activity.

26. Section EE 6(3) describes when intangible property (such as resource consents) will be depreciable property. The crucial requirement is that the property comes within the definition of depreciable intangible property in s EE 62. Section EE 62 restricts depreciable intangible property to the items listed in sch 14. Environmental consents are depreciable intangible property as they are listed in sch 14(10). But for their inclusion in sch 14, environmental consents might be considered inseparable from the asset to which they relate. However, the impact of sch 14 is that environmental consents are treated as separate assets for depreciation purposes and their costs cannot be capitalised into another asset.

27. Assuming an environmental consent meets the requirements of ss EE 1 and EE 6, it is an item of depreciable intangible property and the cost can be depreciated over its life using the straight-line method (s EE 12(2)(b)(ii)).

28. For environmental consents, this means expenditure on the application, administrative fees under s 36 of the RMA, legal fees (not deductible under s DB 62) in relation to the consent, hearing costs and expenditure on preparing and compiling the assessment of environmental effects are likely to all be part of the cost of the resource consent and depreciable over its

fixed life. Whether other expenditure is depreciable as a cost of the consent is a question of fact. For instance, engineering and civil design reports may have been commissioned solely to address a crucial issue relevant to the resource application, in which case the expenditure will be directly attributable to the resource consent. In other circumstances such reports might be a cost directly attributable to the construction of the resulting tangible asset. Where the expenditure is directly attributable to more than one item of property, the expenditure should form part of the cost base of the items on a basis that is appropriate in the circumstances.

Land consent expenditure capitalised into other depreciable property

29. Land consents (unlike environmental consents) are not listed as items of depreciable intangible property under sch 14. Consequently, they are neither depreciable intangible property under s EE 62 nor depreciable property under s EE 6(3). An exception exists for land consents that are a right to use land under sch 14(5). However, the Commissioner considers these will only arise in exceptional circumstances because the consent will have to have a finite useful life (the statutory default in s 123 of the RMA is they have an infinite life) and be a right to use land within sch 14. To be a right to use land under sch 14 it must be a right to use exercised independently from the rights of ownership (*ANZCO Foods Ltd v CIR* [2016] NZHC 1015, (2016) 27 NZTC 22-049, *Trustees in the CB Simkin Trust and the Trustees in the NC Simkin Trust v CIR* (2005) 22 NZTC 19,001, *Trustees of the CB Simkin Trust and the Trustees in the NC Simkin Trust v CIR* (2003) 21 NZTC 18,117).

30. Where a land consent is not a right to use land under sch 14(5), expenditure on a land consent can only be depreciated to the extent that it can be capitalised to the cost base of another item of depreciable property. When changes were made to include environmental consents in sch 14, the intention was that, for depreciation purposes, the cost of land consents that pertain to the erection of a structure should be included in the cost of the structure. A similar intention was also evident in subsequent changes to (what is now) s DB 19. The section was specifically amended to more clearly allow deductions for both resource consents that were depreciable in their own right (ie, environmental consents) and as part of other depreciable property. From s DB 19 it can be inferred that Parliament's intention is to allow resource consent expenditure to be capitalised into the cost of another item of depreciable property. To the extent that expenditure is a cost of another item of depreciable property, it can be depreciated. Where the expenditure is directly attributable to more than one item of property, the expenditure should form part of the cost base of the items on a basis that is appropriate in the circumstances. There will be no deduction when the land consent is capitalised into the cost of land and a 0% depreciation deduction for buildings with an EUL of 50 years or more.

Part One – Key concepts

31. The ability to deduct or depreciate expenditure on a resource consent depends on the type of consent. It is necessary to understand the different types of resource consents for tax purposes. Some resource consents are depreciable intangible property and depreciable as a stand-alone asset. Some resource consents may be capitalised into the cost of another asset and depreciated as part of that asset. Once the type of resource consent is identified, it is then necessary to identify what expenditure is included in the cost base of the resource consent (or another asset) for depreciation purposes. These key concepts as they relate to deductibility of expenditure on resource consents must be understood against the background of the Supreme Court decision in *Trustpower Limited v CIR* [2016] NZSC 91. Part One of this statement addresses:

- different types of resource consents;
- the meaning of "cost"; and
- *Trustpower v CIR*.

Different types of resource consents

32. The different types of consents are identified in s 87 of the RMA, but for tax purposes resource consents can be divided into two groups depending on whether they are items of depreciable intangible property listed in sch 14.

33. The first group includes those resource consents not in sch 14. Consents issued under ss 9 and 11 of the RMA, along with reclamation consents, all broadly concern land. They are referred to as "land consents". These consents are characterised as follows:

- Section 9 of the RMA provides for a restriction on the use of land that contravenes national environmental standards, a regional rule or a district rule.
- Section 11 of the RMA provides a restriction on subdivisions. Under s 218 of the RMA the definition of subdivision is wider than the common meaning of dividing a section of land into separate titles. For instance, the definition includes the grant of certain leases.

- Reclamation consents are a subset of ss 12–14 of the RMA consents. These are specifically excluded from being depreciable intangible property and so are grouped with ss 9 and 11 of the RMA consents. Reclamation consents concern permanent changes to land and are more like land consents than ss 12–15 of the RMA consents.

34. The second group includes those resource consents in sch 14. Resource consents issued under ss 12–15 of the RMA broadly concern resources and the environment and are referred to as "environmental consents":
    - Section 12 restricts the use of coastal marine areas.
    - Section 13 restricts certain uses of beds of lakes or rivers.
    - Section 14 provides restrictions relating to water.
    - Sections 15, 15A, and 15B restrict the discharge of contaminants; this includes various scenarios involving discharges, dumping and incineration.
35. The RMA treats these two types of consents differently:
    - Land consents are of unlimited duration unless specified otherwise (s 123), are usually attached to the relevant land and can be enjoyed by the owners and occupiers of the land (s 134).
    - Environmental consents have a 5–35-year life span (s 123) and can be transferred (ss 135–137).
36. The default position is land consents are granted for an unlimited duration but the consent can specify a 5–35-year period. Land consents may be for a limited duration where they are issued for short-term activities such as concert performances (for excessive noise levels), carnivals on the beach (for exclusive occupation of space) and flea markets in car parks (where they involve the construction of structures that require resource consent). Time-limited consents may also be required for temporary events, such as the America's Cup or British and Irish Lions rugby events.
37. Despite having a finite or infinite life, consents can lapse (if they are unused), be cancelled or surrendered (ss 125, 126, and 138 of the RMA). The consent can also be changed. Section 127 of the RMA allows the consent holder to apply to change or cancel conditions attaching to a consent.
38. The RMA also sets out the process for obtaining resource consents. The exact process and the cost will vary greatly depending on the circumstances. If the consent is "notified", the process can involve advertising, seeking submissions, pre-hearing meetings, a formal hearing, a formal decision and even mediation. Where an application is not notified or subject to limited notification, the process is less arduous. In addition, the RMA allows a right of appeal so there may be litigation and further appeals after an initial decision.

The meaning of "cost"

39. For the purposes of determining the amount that is depreciable, it is necessary to determine the cost of the resource consent. There is very little assistance in the legislation as to what constitutes "cost". The term "cost" is used repeatedly in the Act but is not defined for depreciation purposes. The current depreciation regime was based on the Valabh Committee's recommendations. The summary to Chapter 1 of the *Final Report of the Consultative Committee on the Taxation of Income from Capital* (February 1991) concluded that it was not possible to apply a general costing rule or definition to the entire Act because cost concepts are only capable of definition in a particular context. Case law also recognises "cost" is capable of variable meanings and of longer or narrower construction according to the subject matter and circumstances of the particular case (*Wilke v CIR* (1998) 18 NZTC 13,923 citing *PM Scientific Fur Cleaners Ltd v Home Insurance Co* (1970) 12 DLR (3d) 177, 184).
40. The Commissioner has published several items on the meaning of "cost" in particular circumstances, including:
    - IS 10/06: "Deductibility of business relocation costs" (*Tax Information Bulletin* Vol 22, No 8 (September 2010));
    - QB 15/13: "Income tax – whether the cost of acquiring an option to acquire revenue account land is deductible" (*Tax Information Bulletin* Vol 28, No 1 (February 2016));
    - BR Pub 09/08: "Cost price of the vehicle" – meaning of the term for fringe benefit tax purposes" (*Tax Information Bulletin* Vol 22, No 1 (February 2010)); and
    - IS 17/05: "Income tax – treatment of New Zealand patents" (*Tax Information Bulletin* Vol 29, No 6 (July 2017)).
41. When dealing with resource consents, the Commissioner considers the following principles are key:
    - Cost **includes** that which must be given in order to acquire something. A transaction should be viewed in its commercial reality and it is possible to look at business practice and accepted accounting standards.
    - Cost **includes** expenses incurred in having an asset installed and ready to use but cost is fixed once the asset is capable of being used.

- Cost **includes** subsequent expenditure after this point only to the extent that it is allowed under the Act; see ss EE 19 and EE 37.
- Cost **does not include** all expenditure associated with the asset where it does not satisfy one of the above principles.

Cost includes that which must be given in order to acquire something

42. The definition of cost as "that which must be given in order to acquire something" comes from case law, notably *Tasman Forestry Limited v CIR* (1999) 19 NZTC 15,147 (CA).

43. In *Tasman Forestry* the taxpayer was allowed a deduction for the cost of certain forestry assets against profits or gains derived from the sale of timber. The Court of Appeal was concerned with determining the cost of the forestry assets acquired. The Court of Appeal adopted the *Shorter Oxford English Dictionary* definition, being "that which must be given in order to acquire something". The Court also stated that "cost" has a wider meaning than payment on purchase, and the fact that determination of cost may require a valuation exercise does not mean there is no cost. Further, the Court stated that the taxpayer's submission that cost is to be equated with economic sacrifice was "perhaps too wide in an absolute sense".

44. The Court of Appeal also noted at 15,157:

> [37] We consider the correct course is not to dissect the transactions by which the forests were acquired, **but to view them in their commercial reality**. As the Judge found, the shares were purchased as the means for, and with the intention of, acquiring the forests. For practical purposes the cost to Tasman in acquiring the forests was the amount paid for the company shares which gave access to the forest assets. The appropriate proportion of that cost is to be treated as the cost of the timber.
>
> [Emphasis added]

45. In *CIR v Atlas Copco (NZ) Ltd* (1990) 12 NZTC 7,327 the High Court also considered the realities of the situation when determining what was meant by cost. The issue in that case was the value of fringe benefits provided by the taxpayer to its employees. The legislation provided that the value of the benefits was to be determined based on the "cost" of the benefits to the taxpayer. The taxpayer argued that this cost did not include the GST component of the relevant expenditure, because ultimately the taxpayer was able to recover that component by claiming input tax deductions. The Commissioner argued that the taxpayer being able to claim back the GST component did not change the fact that the GST component was part of the cost incurred.

46. The High Court found for the taxpayer and considered that the approach suggested by the Commissioner was unduly restrictive and would not give effect to the realities of the situation (at [738]). The Court also had regard to the evidence given by two accountants as to the commonly held commercial understanding of the word "cost". The Court observed that where the meaning of words in a statutory context is unclear or ambiguous, the Court may derive some assistance from common business parlance and practice, as well as international standards.

47. The relevant accounting standards in New Zealand are NZ IAS 16 (where the expenditure is capitalised into a tangible item of depreciable property) and NZ IAS 38 (where the expenditure is a cost of an item of depreciable intangible property). When determining whether an asset that incorporates both intangible and tangible elements should be dealt with under NZ IAS 16 or NZ IAS 38, the accounting standards say taxpayers should use judgement to assess which element is "more significant".

48. Clause 10 of NZ IAS 16 includes in cost the costs initially incurred to construct an item. Clauses 16 to 22A discuss the elements of cost and particularly relevant are:

> 16. The cost of an item of property, plant and equipment comprises:
>
> (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
>
> (b) **any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management**.
>
> (c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.
>
> 17. Examples of directly attributable costs are:
>
> (a) costs of employee benefits (as defined in NZ IAS 19 *Employee Benefits*) arising directly from the construction or acquisition of the item of property, plant and equipment;
>
> (b) costs of site preparation;
>
> (c) initial delivery and handling costs;
>
> (d) installation and assembly costs;

(e) costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and

(f) professional fees.

[Emphasis added]

49. Reading clauses 16 and 17 of NZ IAS 16 together suggests that something as integral to the construction of an asset as a resource consent should be capitalised into the cost of the asset for accounting purposes. NZ IAS 38 is broadly similar and includes the same principle that cost must be directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating. For instance, clause 34 (cost of separately acquired intangible assets) includes "any directly attributable cost of preparing the asset for its intended use" and clause 64 (cost of an internally generated intangible asset) includes "all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management."

50. Accordingly, "cost" is that which must be given in order to acquire the asset. However, a transaction must be viewed in its commercial reality, and assistance may be derived from common business practice or accepted accounting practice.

Cost includes expenditure incurred having the asset installed and ready to use

51. In the Australian case *BP Refinery (Kwinana) Ltd v FCT* 8 AITR 113, Kitto J made the following comments in the context of a discussion of what items were to be included in the cost of an asset for depreciation purposes:

> ...in my opinion, the word **"cost" in section 56(1)(b) bears the meaning which it has in the business life of the community**. It seems to me impossible to suppose that the depreciation provisions of the Act are intended to apply only to those simple cases in which the ascertainment of cost is a purely arithmetical process. I interpret it as embracing the whole sum which, **according to accepted accountancy practice as applied to the circumstances of the case**, ought to be considered as having been laid out by the taxpayer in order to acquire the subject-matter as plant, that is to say **installed and ready for his use as plant** for the purpose of producing assessable income. (p. 117)

[Emphasis added]

52. Kitto J considered that cost has the meaning it has in the business life of the community and that accepted accountancy practice can be used to interpret "cost". This meant the cost included having the property installed and ready for use for the purpose of producing assessable income.

53. Similarly, in *IRC v Barclay, Curle & Co Ltd* [1969] 1 All ER 732, the House of Lords considered that expenditure that had to be incurred before a capital item could be made available for use was part of the cost of the item and was, therefore, capital expenditure. The issue was whether the cost of excavation, which was necessary to enable a dock at a shipping yard to be built, was capital expenditure. Lord Reid commented:

> So the question is whether, if the dock is plant, the cost of making room for it is expenditure on the provision of the plant for the purposes of the trade of the dock owner. In my view this can include more than the plant itself because plant cannot be said to have been provided for the purposes of trade until it is installed: until then it is of no use for the purposes of trade. This plant, the dock, could not even be made until the necessary excavating had been done. All the commissioners say in refusing this part of the claim is that this expenditure was **too remote** from the provision of the dry dock. There, I think, they misdirected themselves. If the cost of **the provision of plant can include more than the cost of the plant itself**, I do not see how expenditure which **must be** incurred before the plant can be provided, can be too remote. (p. 741)

[Emphasis added]

"Cost" for depreciation is restricted to the initial cost of an item

54. The scheme of the Act, *BP Refinery* and *Barclay Curle* indicate that cost is fixed at the point the property is set up and ready to use. At this point the cost is fixed (with some exceptions discussed below) and IS 10/06: "Deductibility of business relocation costs", provides the Commissioner's view on this at [131]:

> In the Commissioner's view the term "cost" as it is used in the depreciation rules is effectively restricted to the initial cost of an item of depreciable property. Case law and commercial practice dictate that included in the initial cost are set-up and installation costs. However, the scheme of the depreciation rules seems to prevent any costs incurred subsequent to the initial setting up of the item from coming within the "cost" of that item unless they qualify under sections EE 18 and EE 19 (variations to cost) or section EE 37 (improvements). If subsequent costs can be implicitly added to the cost of an item of depreciable property it becomes difficult to understand the need for sections EE 19 and EE 37 in the depreciation rules.

Subsequent expenditure added to the cost under ss EE 19 and EE 37

55. Although cost is fixed, it is possible to add additional costs under ss EE 19 or EE 37. Section EE 19 applies to fixed life intangible property. Additional costs can be added to depreciable tangible property if there is an improvement under s EE 37. For intangible property, it will generally be appropriate to use the specific provision of s EE 19 rather than the more general provision of s EE 37.

56. Section EE 19 allows additional costs incurred to be added to the cost of fixed life intangible property for the purposes of the formula in s EE 16:

> **EE 19 Cost: fixed life intangible property**
>
> *When this section applies*
>
> (1) This section applies when—
>
> (a) a person owns an item of fixed life intangible property; and
>
> (b) the person incurs additional costs in an income year for the item; and
>
> (c) the person is denied a deduction for the additional costs other than a deduction for an amount of depreciation loss.
>
> …
>
> *Additional costs for fixed life intangible property*
>
> (2) For the purposes of the formula in section EE 16, the item's cost at the start of the income year is treated as being the total of—
>
> (a) the item's adjusted tax value at the start of the income year; and
>
> (b) the additional costs the person incurs.

57. While "additional costs" are not defined, there is guidance in some of the supporting materials. Section EE 19 was originally added in 1997 as ss EG 2(3) and EG 8 to the Income Tax Act 1994 as part of the review of the depreciation rules. The focus in the Commentary to the Taxation (Remedial Provisions) Bill 1997 (and echoed in *Tax Information Bulletin* Vol 9, No 12 (November 1997)) is renewal fees and the example used is where an option to renew is exercised and money is paid to extend the life of the intangible property. The Commentary notes the specific issue the amendment is addressing:

> When a taxpayer incurs additional capital costs during the life of a FLIP, the current mechanism results in part of those costs being deductible only on disposal of the asset. This will generally occur if a taxpayer has a right or contract that may be renewed conditional on the payment of pre-determined fees. The legal life of property includes any such period of renewal.

58. Despite this, s EE 19 is drafted widely and the *Concise Oxford English Dictionary* (12th Edition, 2011) defines "additional" as:

> extra or supplementary to what is already present or available.

59. "Cost" is that which must be given in order to acquire something (*Tasman*). Based on its plain and natural meaning, "additional costs" are expenditure (or value) extra or supplementary to that already given in order to acquire something. It might be argued that "additional cost" should be interpreted to mean any subsequent expenditure relating to the asset. The Commissioner does not agree with this interpretation. The Commissioner considers that additional costs will usually only apply to expenditure that is an improvement to the asset. Therefore, expenditure incurred after the asset is ready to use and which does not result in an improved asset will not be additional costs.

Some expenditure will not be a cost of the asset

60. Not all expenditure that is associated with an asset will be a cost of that asset. The reasons that expenditure might not be part of the cost base of an asset include the following:

- It is deductible elsewhere in the Act (eg, it is revenue expenditure).
- It is incurred after the cost of the asset has been fixed.
- It is a cost directly attributable to another item of property for depreciation purposes.

61. Section EE 16(4)(b)(ii) states that when a person uses a straight-line method to calculate their loss, the item's cost excludes expenditure for which the person is allowed a deduction under a provision outside subpart EE. This means the following types of expenditure are **not part of the cost of an asset for depreciation purposes**:

- Expenditure that is revenue in nature and deductible on that basis.
- Expenditure that is feasibility expenditure and deductible under the principles in IS 17/01.
- Expenditure otherwise deductible under a specific provision.

"Cost" of a resource consent

62. Having identified the two different types of resource consents and how to determine an asset's cost, the next step is to consider what types of expenditure form the cost base for a resource consent. This is relevant because it is the "cost" of a resource consent that will be depreciable.

Cost includes that which must be given in order to acquire a resource consent

63. Whether expenditure is a cost of the resource consent depends on the facts. Expenditure on the application and administrative fees under s 36 of the RMA is incurred to obtain the resource consent and will be a cost of the consent. Expenditure on legal and hearing costs is also likely to be a cost of the consent.

64. Schedule 4 of the RMA sets out the information required in an application for resource consent. This includes an assessment of environmental effects and schedule 4 also prescribes the information this assessment must include and the matters it must address. Expenditure incurred in compiling the information, reports and strategies for the purposes of the application will generally be part of the cost of the resource consent. This could include expenditure on resource monitoring, environmental investigations, engineering reports and the development of mitigation strategies for adverse environmental effects.

65. On larger projects, consultation will often be a necessary step in the process of applying for resource consent. Expenditure on public awareness campaigns, public meetings, mail drops, media releases and consultation with affected persons including iwi, may all be part of the cost of the resource consent. It depends on the particular facts, but all of this expenditure may need to be incurred to acquire a resource consent.

Cost includes expenditure having the asset installed and ready to use

66. Case law and commercial practice allow expenditure incurred in having an asset installed and in getting it ready to use, to be added to the cost base of an asset. It is generally easier to identify this type of expenditure for tangible assets than it is for intangible assets. For example, it is usually straightforward to identify installation and setup costs for an item of depreciable plant. There appears to be less scope for this type of expenditure on an intangible asset because:
    - The nature of fixed life intangible assets is that they will start to depreciate at the point in time when the asset's life span begins to reduce. Once obtained it will usually be "available to use" (the requirement in s EE 1(2)(c)) and depreciable. Once an item is available to use, the cost of the item is fixed, and it is too late to add subsequent costs to the cost base (outside of the provisions of the Act).
    - Unlike tangible assets, there is unlikely to be any element of installation.

67. However, there is still some scope to incur expenditure that would be a cost of getting the resource consent ready to use. This seems most likely to arise where the consent has been granted but has not commenced. Under the RMA, a consent does not commence until s 116 is satisfied. There are a number of situations where commencement may be delayed, for instance when the grant of the consent is appealed. Until the resource consent commences it will neither be available for use nor capable of depreciating in value (because its fixed life is not diminishing).

68. If a resource consent is subject to a condition that must be fulfilled **before the consent commences** then this expenditure, although incurred after the consent has been granted, may be a cost of getting the resource consent ready to use. In these circumstances the expenditure should be added to the cost base of the resource consent.

69. Following commencement, a condition will not usually be enough to prevent a resource consent being available to use. Under s 108 of the RMA, councils have very wide powers to impose conditions on resource consents. However, the conditions imposed must still be reasonable and a condition cannot be a condition precedent to the granting of the consent. For more information on conditions, see IS 08/03: "Resource consent application fees and provision of works, provisions of information and transfer of land as conditions of resource consent – GST treatment", *Tax Information Bulletin* Vol 20, No 8 (September/October 2008). Although non-compliance with a condition may eventually lead to some level of enforcement, it will not usually stop the consent from being available to use.

70. Once a resource consent is available to use, any expenditure incurred on meeting the conditions of the consent will not be a cost of the consent unless s EE 19 or s EE 37 applies.

Subsequent expenditure added to the cost under ss EE 19

71. Environmental consents are fixed life intangible property and s EE 19 allows additional costs incurred to be added to the cost of fixed life intangible property for depreciation purposes. In the context of a resource consent, the consent will already have been acquired. To be an "additional cost" of the depreciable resource consent, the expenditure needs to be acquiring something more in relation to the consent, such as an enhancement or improvement to the resource consent by amending an onerous condition. For the purposes of environmental consents, "additional costs" will likely include expenditure incurred under ss 125, 126 and 127 of the RMA to make changes to the consent and its terms.

72. Expenditure incurred on the conditions attaching to a resource consent will not usually be part of the cost base of a resource consent as the expenditure will be incurred after the cost base is fixed. The only way this can be included is if it is an "additional cost" under s EE 19. Expenditure on meeting the conditions attached to a granted environmental consent will generally not be an additional cost under s EE 19 because to be a "cost", the expenditure must be given to acquire "something". In this case, the "something" (being the resource consent) has already been obtained. Expenditure on satisfying conditions will often be directed at other assets or purposes distinct from the consent itself and may still be deductible, for example, it might be revenue expenditure or a cost of another item of depreciable property. For instance, a resource consent may be subject to a condition requiring the consent holder to build a retaining wall. Expenditure incurred **on removing or modifying conditions** is an additional cost under s EE 19 as it enhances or improves the resource consent – something additional in respect of the consent is obtained.

73. Section EE 37 is broadly similar to s EE 19 as it allows additional expenditure on improvements to be added to the cost of an item of depreciable property. Given s EE 19 specifically deals with intangible property the statutory interpretation principle that the specific provision overrides the general provision means that s EE 19 should be used when dealing with resource consents.

Example 1

XYZ Quarries obtains an environmental consent for a new quarry. However, a downturn in construction and competition from overseas mean the site is dormant and the consent is never used. Nearly five years later market conditions change, and the quarry becomes viable. Because the unused consent is due to lapse (under s 125 of the RMA) the quarry owner applies to the local council under s 125 to extend the period. The costs associated with the application run to $12,000 as the quarry owner engages experts to provide reports on the market conditions and the effects of the extension on the district plan.

The $12,000 is an additional cost under s EE 19 and can be added to the cost of the existing consent and depreciated as part of the cost of the resource consent. The expenditure is capital in nature and incurred under the RMA to secure an extension to the terms of the consent.

Expenditure directly attributable to multiple items

74. Where expenditure is directly attributable to more than one item of property, the expenditure should form part of the cost base of the items on a basis that is appropriate in the circumstances.

75. Where the expenditure serves two or more objects indifferently and dissection is impractical, then it must be apportioned on a fair and reasonable basis. It is impossible to prescribe any precise formula applicable to all cases because the circumstances of the particular case will usually determine the most appropriate way of deciding how to apportion an amount. However, the case law says the apportionment must be fair, not arbitrary, and must be done as a matter of fact (*Buckley & Young v CIR* (1978) 3 NZTC 61,271 (CA)). In apportionment cases the onus of proof lies with the taxpayer (*Buckley & Young*). However, it is recognised that absolute precision cannot be expected and a reasonable estimate will be sufficient (*Omihi Lime Co Ltd v CIR* [1964] NZLR 731). Some fair and reasonable bases for apportionment may include (*Buckley & Young*):

- the respective values of the advantages arising from the expenditure; and
- where the advantages do not lend themselves to measurement, some particular part or fractional share of the total expenditure if the part or share can be established on the basis of sufficient evidence.

76. The Commissioner will accept apportionment of the expenditure on a reasonable basis between the items of property. For instance, when applying for an environmental consent to develop a hydroelectric plant, the taxpayer will likely need designs for the turbine that will be placed into the water. If the designs are high-level drawings undertaken for the resource consent application, then it might be reasonable to allocate the full cost of these designs to the resource consent. On the

other hand, if the designs are detailed engineering and construction plans that will be used to build the turbine, it may be reasonable to allocate the expenditure on the designs to the cost of the turbine and nothing to the resource consent. In other circumstances, the allocation of expenditure may not be so straightforward, and it will be necessary to apportion on a fair and reasonable basis.

Examples of expenditure

77. The Commissioner considers the following types of expenditure to be **examples of expenditure that may** be incurred in the resource consent process.

Examples of expenditure on a resource consent

- Resource monitoring
- Land access
  - Licence fees for access to the land to enable the applicant to carry out resource monitoring and environmental studies
- Consultation
  - Costs of determining who is affected
  - Public awareness campaigns including public meetings, mail drops, media releases
  - Public meetings and one-on-one meetings with affected parties to identify possible opposition and mitigation
  - Development of mitigation, including payments to affected parties
  - Consultation with iwi
- Engineering and civil design necessary to support the resource consent application
- Detailed environmental investigations to determine potential environmental effects and mitigations
  - Impact on flora and fauna
  - Archaeological and cultural impact
  - Social impact
  - Transport assessment
- Other investigations necessary to support the application
  - Noise assessment
  - Dust assessment
  - Visual impact assessment
  - Economic impact
  - Surveys
- Salaries and overheads of employees directly involved in the resource consent application and travel and accommodation connected to the consent process
- Project management and legal support
- Application and processing fees for consent application
- Preparation of Assessment of Environmental Effects (AEE)
- Peer review of engineering, civil and environmental studies
- Preparation of evidence and submissions for consent hearing
- Detailed financial and economic studies
- Design and creation of areas to mitigate environmental effect
- Development of other mitigation strategies for adverse environmental effects

- Hearing costs of consent authority
  - Includes pre-application meetings, pre-hearing meetings and mediation
  - Payments to experts
  - Legal fees
  - Further environmental and engineering studies to provide responses to requests for further information by hearing authority
- Consideration of hearing authorities' decision and considering conditions of consents if granted
- Appeal costs

78. The expenses in the table are examples of the types of expenses that might be incurred in obtaining a resource consent. Whether a particular expense forms part of the cost base of the resource consent depends on the facts (see discussion on "cost" from [39] onwards). For instance, expenditure on legal fees may be expenditure that can be deducted under s DB 62 rather than treated as a cost of the consent. Also, engineering reports may be a cost of the resulting item of plant, rather than a cost of the resource consent.

Summary

79. Whether expenditure is a cost of the depreciable resource consent depends on the facts. Case law defines cost as "that which must be given in order to acquire something" (*Tasman Forestry*). A transaction must be viewed in its commercial reality and assistance may be derived from common business practice or accepted accounting practice (which may involve considering whether the expenditure is directly attributable to a particular asset).

80. For a resource consent, the cost is effectively restricted to the initial cost of an item of depreciable property. Case law and commercial practice allow set-up costs to get an asset ready to use to be included in the asset's cost. Whether expenditure is incurred in getting a resource consent ready to use is a question of fact. However, it would be unusual to incur any such expenditure once the period for which the consent has been granted has commenced. Although, it may still be possible to add further expenditure to the cost of a resource consent after the cost is fixed under s EE 19.

81. Not all expenditure associated with a resource consent will form part of its cost base. For example, an expense may have been incurred as an ordinary incidence of business and is deductible under the general permission, in which case it will not be a cost of the consent. Alternatively, the expenditure may have been incurred on meeting a condition of the consent after the cost of the consent has been fixed, in which case it will not be a cost of the consent.

Example 2

New Zealand Molluscs Ltd farms oysters for export. It has identified a sheltered harbour that would suit a pacific oyster farm. An environmental consent is obtained to place and use a number of inter-tidal racks within the harbour. When the consent is granted, there are a number of conditions, including the following:

- Water quality must be tested regularly, and any change reported to the council.
- All equipment used in the harbour must be cleaned regularly and checked for leaks.
- A small area of hardstanding for a car park is required for company employees working at or visiting the site to avoid cars driving on to the beach and disturbing wildlife.

Expenditure on meeting these conditions will not be a cost of the consent. Firstly, in terms of timing, the consent is available to be used and starts to depreciate as soon as it commences. At this point the cost has become fixed and the expenditure on the conditions is incurred too late to be a cost of the consent.

The first two conditions relate to costs that are an ordinary incidence of doing business, and as such are revenue expenditure and deductible on that basis. The expenditure is recurring and does not result in an enduring capital benefit. Monitoring water quality and cleaning and maintaining equipment is an ordinary incidence of business for the company. The expenditure incurred in creating an area of hardstanding for a car park is a cost of the car park – not of the consent. This expenditure is depreciable as a cost of hardstanding under sch 13.

There is also a condition requiring the tidal racks to be located at an exact height and position. However, the company subsequently discovers that the inter-tidal racks would be more productive if their position was altered. It applies under s 127 of the RMA to change the condition of the consent to allow it to re-position the inter-tidal racks. This expenditure is an additional cost under s EE 19 and must be added to the cost of the consent.

INTERPRETATION STATEMENTS

Trustpower v CIR

82. Before considering specific situations in which expenditure on resource consents may arise, this statement will address the Supreme Court decision in *Trustpower*. The case is the most recent authority concerning the tax treatment of expenditure on resource consents.

83. Trustpower maintained a "development pipeline", which consisted of over 200 possible electricity generating projects, not all of which would be carried through to completion. This case concerned four particular projects and in dispute was the deductibility of expenditure on applying for and obtaining resource consents. The total spent was approximately $17.7m.

84. As a result of the expenditure, Trustpower had obtained resource consents (land use consents, water permits and discharge permits). Apart from some of the land use consents that were of an unlimited duration, the consents were for fixed periods (generally 10, 15 or 35 years). The projects were all in limbo and it was unclear whether they would be abandoned or advanced. Despite this, the Supreme Court thought it reasonable to suppose that the projects were still marketable and they noted that Trustpower had been approached about its willingness to sell two of them.

85. The arguments were refined over the course of the hearings. In the High Court, Andrews J considered the expenditure was revenue in nature primarily because the resource consents were inseparable from what was considered to be revenue account property. Whether the consents were separate property was irrelevant to the approach of the Court of Appeal and Supreme Court, who both considered that the expenditure was capital in nature. The focus of *Trustpower* is fairly narrow but in the Commissioner's view the following principles can be drawn from the litigation:
    - Resource consent expenditure is usually on capital account.
    - There is limited scope for deductible feasibility expenditure in the context of applying for a resource consent. (See IS 17/01).
    - Consents within sch 14 (ie, environmental consents) are depreciable intangible property. This means that capital expenditure that is a cost of the property can be depreciated over the fixed life of the consent.
    - Sometimes expenditure on resource consents will be part of the cost of other property, which may or may not be depreciable property.

86. This statement will now discuss these principles as they are key to how resource consent expenditure is treated.

Resource consent expenditure is usually on capital account

87. The principles that need to be applied in determining whether expenditure is capital or revenue were comprehensively considered by the Courts in *Trustpower*. The principles identified included the following:
    - It is necessary to consider what the expenditure is calculated to effect from a practical and business point of view (*Hallstroms Pty Ltd v FCT* (1946) 72 CLR 634 (HCA)).
    - The contrast between the two forms of expenditure corresponds to the distinction between the costs of creating, establishing, acquiring or enlarging the permanent structure of a business (capital) and the costs of using the structure to earn income, or performing the income-earning operations (revenue) (*Commissioner of Taxes v Nchanga Consolidated Copper Mines* [1964] AC 948 (PC)).
    - The indicia discussed in *BP Australia Ltd v Commissioner of Taxation for the Commonwealth of Australia* [1966] AC 224 (PC) can be used to assist in the determination, but they are not determinative in themselves.
    - In the end, the answer will depend on a close examination of the facts of the particular case and the character of the particular payment to ascertain the nature and purpose or effect of the relevant expenditure.

88. Applying the principles and the approach of both the Court of Appeal (*CIR v Trustpower Ltd* (2015) 27 NZTC 22-010) and Supreme Court, expenditure on obtaining a resource consent will usually be capital in nature. The Court of Appeal set out the previous case law that supports this view (the Supreme Court also discussed these cases in a similar manner):

    > [82] In both England and New Zealand expenditure incurred in obtaining resource consents and permissions has been held to be on capital and not revenue account:
    >
    > (a) In *ECC Quarries Ltd v Watkis (Inspector of Quarries)* Brightman J in the English High Court held that while the permissions for a quarry would not themselves produce profits the subsequent operations of working and winning the minerals, which were permitted by the consents, would. Therefore, the assets of the company had radically and enduringly changed when the permissions were granted, and on common sense principles and based on consideration of the authorities, the expenditure was of a capital nature.
    >
    > (b) In *Waste Management New Zealand Ltd v Commissioner of Inland Revenue* this Court indicated that expenditure incurred investigating the feasibility of a site as a landfill for disposing of industrial waste, designing the landfill and seeking the planning

INTERPRETATION STATEMENTS

consents and water rights it needed was capital.

(c) In *Case T53* the New Zealand Taxation Review Authority (Judge Barber), with a brief reference to the decision in *ECC Quarries Ltd*, held that legal fees incurred in a successful appeal against the refusal of resource consents required to carry on a second-hand machinery business were not deductible on revenue account because the acquisition of the resource consent was an intangible asset of the objector's business, a right [sic] of benefit and advantage that did not previously exist.

(d) In *Milburn New Zealand Ltd v Commissioner of Inland Revenue* Wild J in the New Zealand High Court, relying on *ECC Quarries Ltd*, held that expenditure incurred in obtaining resource consents for Milburn's quarries for sourcing aggregate and lime for its cement and concrete business was of a capital not revenue nature because it was a necessary part of the development of those quarries for production of materials for use in the taxpayer's business. It was relatively clearly of a capital nature. [footnotes omitted]

89. The Supreme Court recognised at [29] that expenditure associated with resource consents could be revenue. However, there is a legislative assumption that it will usually be capital:

> We agree with the Court of Appeal on this to the extent that we accept that there are circumstances in which expenditure associated with applications for resource consents are on revenue account. But both the explanatory note and the commentary are suggestive of a legislative understanding that such expenditure will usually be on capital account; thus the need for s DB 13B [now s DB 19].

90. The Court also made similar comments about the legislative assumption at [49]:

> Such assistance as can be derived for [sic] the statutory text is in favour of the Commissioner rather than Trustpower. This is by reason of the specific provisions [ie, s EE 6, Schedule 14 and s DB 19] of the 2004 and 2007 Acts as to (a) resource consents being depreciable property and (b) deductibility of expenses associated with failed or withdrawn resource consent applications and abandoned consents. **These provisions suggest a legislative assumption that, in the absence of such provisions, resource consent expenditure is usually on capital account.**
>
> [Emphasis added]

91. The Supreme Court also provided an example of when expenditure on a resource consent will be revenue in footnote 21 of the decision:

> By way of example, resource consents may form part of the stock-in-trade of a land-developer/speculator and, if so, the costs of obtaining them are obviously on revenue account.

92. In conclusion, expenditure on a resource consent will usually be capital in nature, although there are exceptions to this, such as land developers or traders, where the expenditure may be on revenue account.

Limited scope for deductible feasibility expenditure in the context of applying for resource consent

93. In the Supreme Court much of the argument concerned whether the expenditure on resource consents was feasibility expenditure (and deductible on this basis). Ultimately, the Supreme Court considered it was not because the expenditure on the resource consents was directed towards a specific capital project or directed to materially advancing a specific capital project. Accordingly, even if recurrent, it was not deductible. The Supreme Court considered at [72]:

> The expenditure on obtaining resource consents in this case was directly related to specific projects that would be on capital account if they came to fruition. The projects could not proceed without resource consents. Obtaining the consents thus represented tangible progress towards their completion. The expenditure is thus on capital account and not deductible.

94. The Supreme Court did acknowledge that there is some scope for feasibility expenditure in a resource consent context at [72]:

> We are not required to determine the status of the expenditure which preceded the decisions to apply for resource consent. It may be that the Commissioner could have denied deductibility in relation to at least some of that expenditure. **We are, however, also of the view that expenditure associated with early stage feasibility assessments may be deductible. Such assessments can be seen as a normal incident of business.** Treating the associated costs as deductible is consistent with the passages of the judgments of Noel ACJ and Davies J which we have set out. It is also consistent with the use of the expression "to the extent" in the capital limitation, which, as noted, suggests that questions of degree may be involved. Expenditure which is not directed towards a specific project or which is so preliminary as not to be directed towards the advancement of such a project is likely to be seen as being on revenue account. [footnotes omitted]
>
> [Emphasis added]

95. This leaves limited scope for deductible feasibility expenditure when it comes to applying for a particular resource consent. In most instances, expenditure incurred in applying for a resource consent is expenditure directed towards a specific capital project or expenditure that materially advances a capital project.

Schedule 14 consents are depreciable intangible property

96. It was not necessary for any of the Courts to address depreciation in any detail. However, the Supreme Court did refer to time-limited resource consents within s EE 53 (now s EE 62) as being both depreciable and depreciable intangible property:

> [24] The s OB 1 definition of "property" expressly encompasses resource consents. **Resource consents are within the s EE 53 meaning of "depreciable intangible property" and are "depreciable property" for the purposes of s EE 6 when they are time limited unless the costs of obtaining them are deductible.** This means that the question whether a time limited resource consent is depreciable or not turns on the application of the capital/revenue distinction. We accept therefore that s EE 53 does not resolve the case in favour of the Commissioner. [footnotes omitted]

[Emphasis added]

97. The reference to resource consents within s EE 53 (now s EE 62) encompasses environmental consents because these are listed (in what is now) sch 14 as depreciable intangible property. The Supreme Court considered that consents within (what is now) s EE 62 and sch 14 are depreciable intangible property and the costs are depreciable **unless** the cost can be deducted as revenue expenditure. In most cases the expenditure will not be revenue and the correct approach will be to depreciate the cost over the fixed life of the consent.

Expenditure on resource consents can be a cost of other property

98. Cases such as *ECC Quarries Ltd v Watkis* (HMIT) [1975] All ER 843 (which concerned planning permission rather than a resource consent) and *Milburn NZ Limited v CIR* (2001) 20 NZTC 17,017, provide support for the view that resource consents will often be inseparable from the asset to which they relate. In such instances expenditure on a resource consent is likely to form part of the cost base of that asset.

99. The existing case law was considered by the High Court (*Trustpower Ltd v CIR* (2013) 26 NZTC 21-047) because whether the resource consents were a stand-alone asset was a central issue before the High Court. However, as the arguments developed on appeal, this particular issue was not considered further. Nonetheless the High Court seemed to accept (and the appellate courts did not disagree) that resource consents could be either separate items or part of another item (in which case the tax treatment was what applied to the other item).

100. In the High Court Andrews J concluded:

> [97] On the particular facts of this case, I therefore find that the resource consents obtained by Trustpower for the Arnold, Kaiwera Downs, Mahinerangi, and Wairau projects are not stand-alone assets, separate from the projects to which they relate. The resource consents are part and parcel of the projects. It would be artificial from a practical and business point of view to regard them as separate assets in their own right. The expenditure in obtaining them must, therefore, be treated in the same manner as the projects …

101. This issue was not considered further on the subsequent appeals (it was unnecessary to decide the issue), and the Court of Appeal accepted Andrews J's finding that the resource consents were not stand-alone assets:

> [85] We start our consideration of the application of the general principles relating to the income/capital distinction **by accepting the factual findings made by Andrews J in the High Court relating to Trustpower's development pipeline for its possible future electricity generation projects, including her finding that the resource consents were not stand-alone assets, separate from the projects to which they related. In other words, we proceed at this stage on the basis that it is unnecessary** to determine the Commissioner's challenges to those findings. We take this course because, as Mr Harley accepted in the course of argument, the correct approach is an objective one. Determining on which side of the line the expenditure falls involves an objective analysis of the factual background relating to the nature and purpose or effect of the expenditure and not a subjective approach based on the views of the witnesses for Trustpower. [footnotes omitted]

[Emphasis added]

102. However, this finding was made on the basis that the depreciation rules in subpart EE did not apply. The Supreme Court indicated (see [96] above) that in the depreciation context, environmental consents are discrete items of depreciable intangible property. The Commissioner agrees and considers the effect of the specific statutory regime in s EE 62 and sch 14 is to treat environmental consents as separate property for depreciation purposes (see paragraphs [152]–[153]).

103. In conclusion, the Courts in *Trustpower* accepted that resource consents are capable of being part of another asset, and in that case, the tax treatment is that which applies to the other asset. Although not directly addressed, this suggests that where a land consent is inseparable from a resulting item of depreciable property, the expenditure can potentially be depreciable as a cost of the resulting item of property (see paragraphs [176]–[180]).

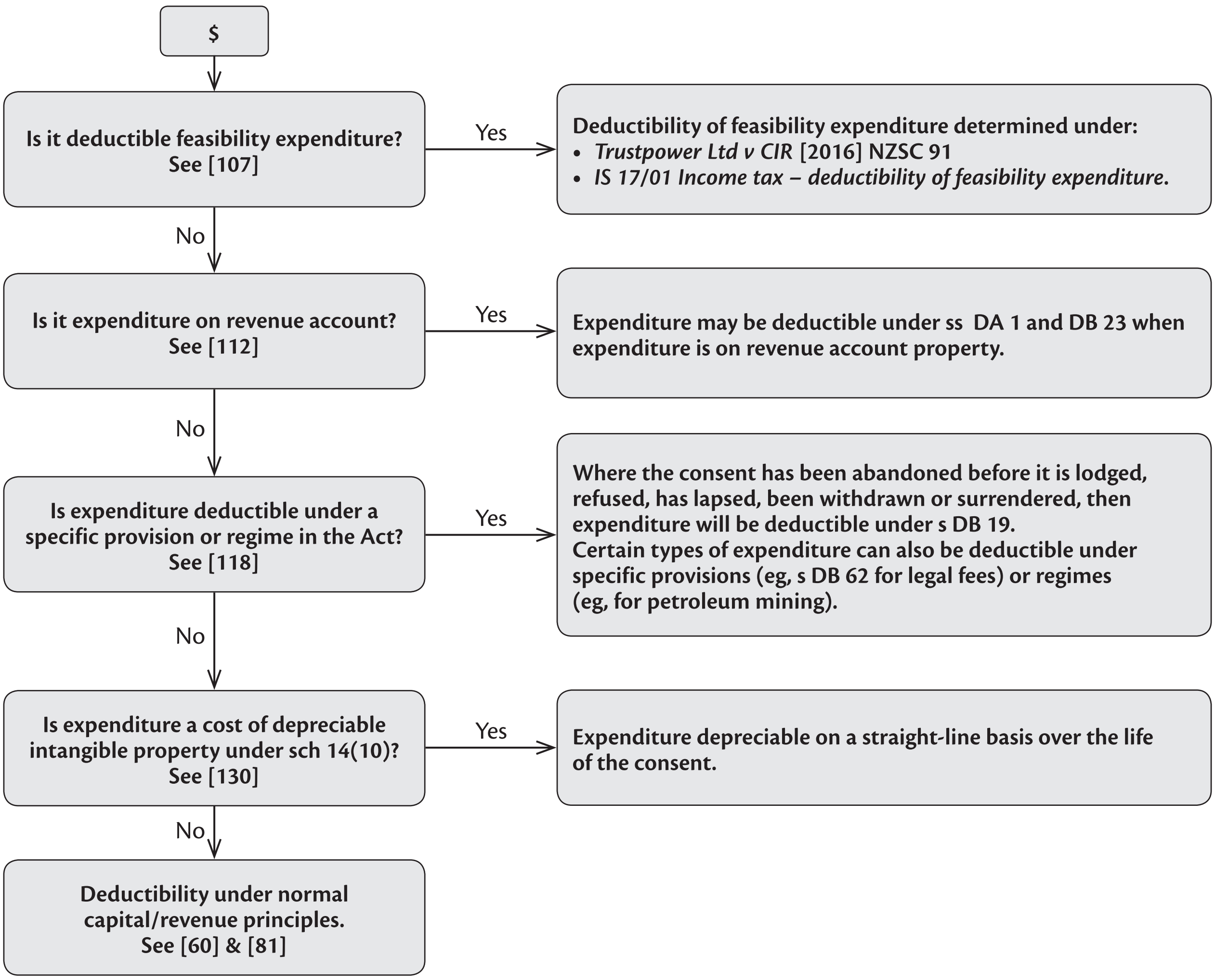
Part Two – Deductibility of expenditure on resource consents

104. The next section of this interpretation statement addresses the different treatment of expenditure on resource consents. Having addressed the key concepts in Part One, Part Two steps through the flowcharts and explains the factors and issues that are relevant in determining the deductibility of expenditure on a resource consent. Accordingly, the statement covers:

- feasibility expenditure that is deductible under the principles in IS 17/01;
- expenditure on revenue account;
- deductibility under a specific provision of the Act, in particular:
  - s DB 19 may allow a deduction for the costs incurred in un-lodged, withdrawn, refused, lapsed or surrendered resource applications;
  - s DB 46 allows deductions for certain expenditure in avoiding, remedying, or mitigating the effects of contamination;
- capital expenditure and the ability to depreciate depending on whether the taxpayer holds:
  - an **environmental consent** – the costs of which will be depreciable as depreciable intangible property;
  - a **land consent** – in which case expenditure incurred in obtaining the consent is only depreciable if it forms part of the cost base of a resulting item of depreciable property (there will be no deduction for land, and buildings with an EUL of 50 years or more have a zero deduction because of the 0% depreciation rate).

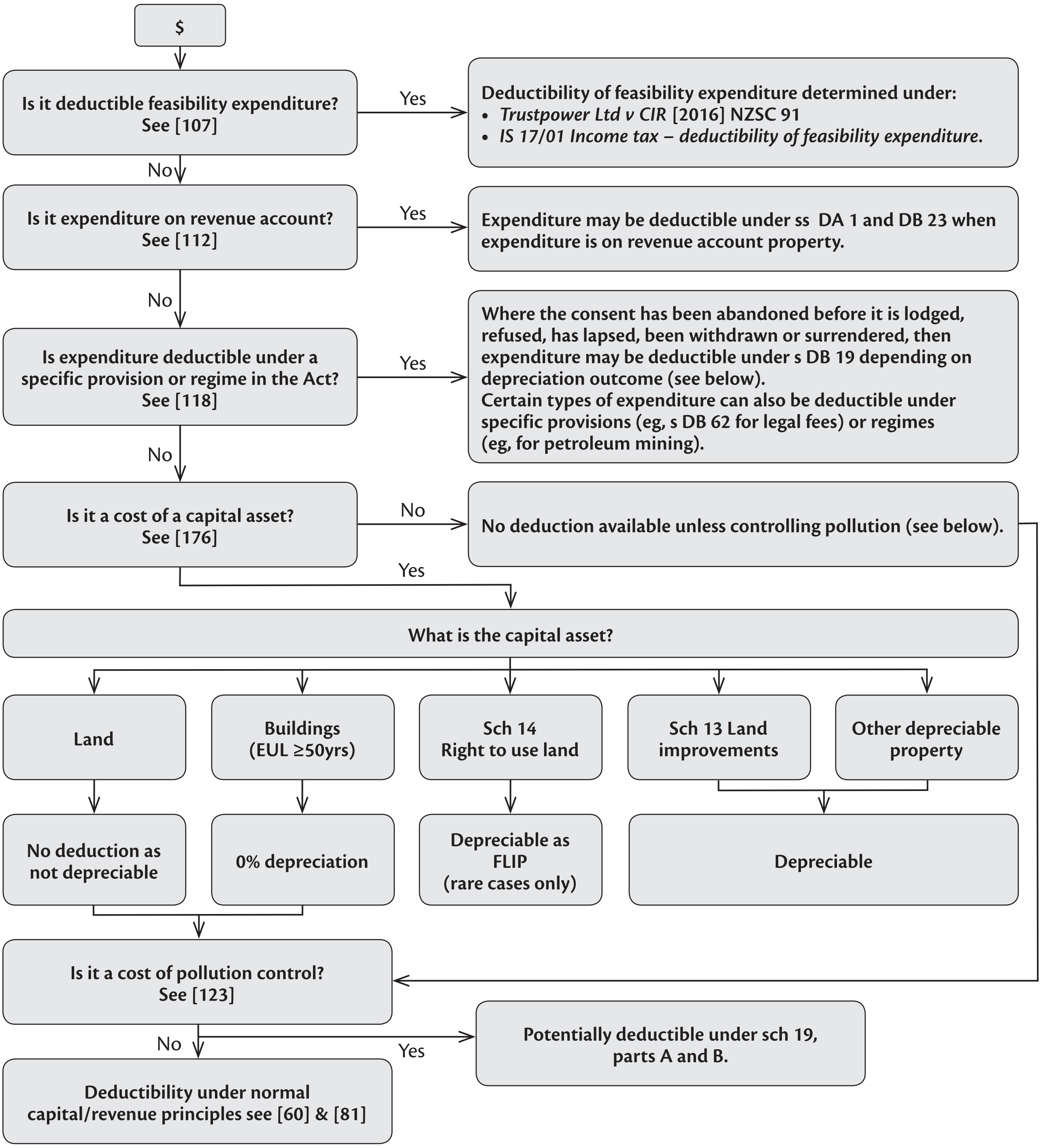
105. The flowcharts are intended to provide a pathway to deductibility to assist in deciding whether expenditure is deductible or depreciable. They are also intended to be a reference tool to guide taxpayers to the part of the statement that is relevant for them. For instance, if expenditure on an environmental study is deductible feasibility expenditure under the principles in IS 17/01 and *Trustpower*, then there is no need to consider whether it is deductible on any other basis. If it is not deductible feasibility expenditure, then the next consideration is whether it is revenue expenditure and deductible under the general permission (and so on).

Flowchart 1: Environmental consents – ss 12–15 of the RMA excluding reclamation consents – treatment of expenditure



106. Flowchart 2 for land consents follows the same general structure. The main difference is that land consents do not depreciate. However, the cost of obtaining a land consent may be depreciated where it is capitalised into the cost of an item of depreciable property. No depreciation deduction is available for any expenditure capitalised into the cost of land or buildings (with an EUL of 50 years or more). For land consents, deductibility under s DB 19 for unsuccessful consents may not be possible as it depends on the depreciation outcome. However, some expenditure may be deductible if it is for pollution control.

Flowchart 2: Land consents – ss 9 and 11 of the RMA plus reclamation consents – treatment of expenditure



Feasibility expenditure that is deductible under IS 17/01

107. This part of the statement is concerned with what might be labelled "feasibility expenditure" to the extent that such expenditure can be deducted under the principles in IS 17/01 and *Trustpower*. If taxpayers believe they have incurred expenditure that is deductible on this basis they should refer to IS 17/01: "Income tax – deductibility of feasibility expenditure".

108. The label "feasibility expenditure" is not determinative when considering deductions because the Act does not prescribe a deduction for amounts of "feasibility expenditure". Rather deductibility is determined by the same general principles that apply to all expenditure. For expenditure to be deductible it must meet the requirements in the general permission in s DA 1(1). It is then necessary to consider whether any of the general limitations in s DA 2 deny a deduction. IS 17/01: "Income tax – deductibility of feasibility expenditure" includes a discussion on the general principles of deductibility.

109. IS 17/01 analyses feasibility expenditure in two steps:

- Firstly, whether there is the ability to deduct under s DA 1(1). IS 17/01 identifies that for many taxpayers, feasibility expenditure will be non-deductible because it will have been incurred preliminary to, or preparatory to, the commencement of a business or income-earning activity. The principles to apply to determine when a business or income-earning activity commences are discussed in detail at paragraphs [29]–[98] of IS 17/01.
- Secondly, whether a deduction is prohibited under the capital limitation in s DA 2(1).

110. The Commissioner's view following the Supreme Court's *Trustpower* judgment is summarised in IS 17/01 at [129]:

> Therefore, in the Commissioner's view, expenditure is likely to be deductible in accordance with the Supreme Court decision if it is of a type incurred on a recurrent basis as a normal incident of the taxpayer's business and it satisfies one of the following:
>
> - the expenditure is not directed towards a specific capital project; or
> - if the expenditure is directed towards a specific capital project, the expenditure is so preliminary as not to be directed towards materially advancing a specific capital project – or, put another way, the expenditure is not directed towards making tangible progress on a specific capital project.

111. The Supreme Court considered that expenditure associated with early stage feasibility assessments may be deductible. This may occur where expenditure is incurred in the initial investigation of a project. Example 5 in IS 17/01 demonstrates when expenditure on initial investigations may be deductible feasibility expenditure. However, once expenditure is directed towards a particular consent there is limited scope for deducting feasibility expenditure. This is because expenditure incurred in applying for a particular resource consent will often be directed towards a specific capital asset (or making tangible progress on a specific capital project) and so is not deductible under the principles in IS 17/01 and *Trustpower*.

Expenditure on revenue account

112. The Supreme Court in *Trustpower* considered that expenditure in that case was on capital account. Applying the Supreme Court's approach, the Commissioner considers that expenditure on resource consents will usually be on capital account. This is because resource consents are usually for a substantial or unlimited duration, provide an enduring benefit and also commonly form part of the profit-earning structure of the business.

113. The exception identified in *Trustpower* is land developers where the expenditure is on revenue account. Where property is "revenue account property", its cost is deductible under s DB 23(1). "Revenue account property" is relevantly described in s YA 1 as property that if disposed of for valuable consideration, would produce income for the person (other than income under ss EE 48, FA 5 or FA 9). Where the expenditure is on revenue account property, special matching provisions apply to the timing of the deduction (s EA 2). Generally, the deduction is deferred until the time the property (which is the subject of the consent) is disposed of and the income arises.

114. Identifying other exceptions depends on a close examination of the facts of the particular case and the character of the particular payment to ascertain the nature and purpose or effect of the relevant expenditure. For instance, if a stadium owner needs a land consent to use floodlights to allow the stadium to host night-time concerts and events, this will likely be capital as it provides an enduring benefit and enlarges the business structure by allowing them to host concerts and other events. Alternatively, if a concert promoter obtains a similar consent to use floodlights for a one-off concert event, then arguably there is no enduring benefit and the expenditure appears more likely to be revenue. Ultimately, it is a matter of applying the principles discussed in *Trustpower* (referred to at [87]) to the particular facts of the case.

115. Where a deduction is being claimed, the expenditure must also meet the general principles of deductibility. The two leading cases in New Zealand relevant to general deductibility are *CIR v Banks* (1978) 3 NZTC 61,236 (CA) and *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271 (CA). A more in-depth discussion of the general principles of deductibility is included in IS 17/01. Briefly, where there is expenditure on a resource consent, for a deduction to be claimed it will be necessary for the expenditure to be incurred by the taxpayer:

- in deriving assessable income; and
- as an ordinary incident of a particular business or income-earning activity.

116. The deductibility of expenditure is subject to the general permission under s DA 1(1). For resource consent expenditure to be deductible under either paragraph of s DA 1(1), a sufficient relationship or nexus must exist between the expenditure and the taxpayer's business or income-earning activity. Whether a business or an income-earning activity is being carried on is always one of fact and degree (the commencement of a business or an income-earning activity is discussed in IS 17/01 (at [29]–[106])). Any expenditure on resource consents for private purposes will not satisfy s DA 1 as the expenditure will not be incurred in deriving assessable income (and will also be denied by the private limitation in s DA 2(2)).

117. When resource consent expenditure is revenue in nature and deductible under s DA 1(1), it is still necessary to consider whether the general limitations in s DA 2 apply.

Example 3

Lindsay and Adrian are in partnership as property and land developers. They commonly buy bare land or houses on large plots that they subdivide and sell. They buy an empty 1-hectare site on the outskirts of their town that they rename "Trafalgar Mews". They are dividing Trafalgar Mews into 12 plots, which they will sell.

Lindsay and Adrian obtain s 11 RMA resource consents from the council to subdivide the property into 12 plots. They also obtain s 9 RMA land consents because the density of the housing will be more than is permitted under the district plan. Once the plots are subdivided and capable of being built upon, the plots are sold. As land developers, the land is held on revenue account and costs are deductible under s DB 23. The s 9 and s 11 consents form part of the cost of the land. They also satisfy the general permission in s DA 1, as required by s DB 23. Special timing provisions apply, and Lindsay and Adrian get the deduction for the expenses incurred in obtaining the consents in the year in which they dispose of the property.

Deductibility under a specific provision

118. Obtaining a resource consent can be a complicated and expensive process. Depending on the circumstances, some expenditure may be deductible under a specific provision in the Act. This statement only addresses ss DB 19 and DB 46 as these provisions are the most relevant to resource consents. However, other provisions may also be relevant, for instance, s DB 62 for legal expenses less than $10,000 and ss DB 5 to DB 7 for interest expenditure. Also, some categories of expenditure, such as petroleum mining and mineral mining expenditure, have their own regimes in the Act.

Where a resource consent is not obtained or is surrendered or lapses

119. Section DB 19 allows a deduction for costs where an application for a resource consent is not lodged, withdrawn or not granted. Section DB 19 can be described as a deduction provision for costs of unsuccessful resource consents. It also allows a deduction where a consent lapses (s 125 of the RMA) or is surrendered (s 138 of the RMA).

120. Section DB 19 has been amended on several occasions to increase the scope of the section. The most recent amendments in 2014 were part of a series of amendments to address "black hole expenditure". The section was extended to cover applications that had not been lodged and where the consent had been granted but had lapsed or been surrendered. Section DB 19 currently reads:

> **DB 19 Expenses in application for resource consent**
>
> *When this section applies*
>
> (1) This section applies when a person who incurs expenditure for the purpose of applying for the grant of a resource consent under the Resource Management Act 1991—
>
> (a) does not obtain the grant because the application is not lodged or is withdrawn, or because the grant is refused:
>
> (b) obtains the grant but does not use the resource consent before it lapses or is surrendered.
>
> *Deduction*
>
> (1B) The person is allowed a deduction for the expenditure—
>
> (a) that the person incurs in relation to the application or intended application; and
>
> (b) that would have been part of the cost of depreciable property, or otherwise a deduction, if the application or intended application had been granted or if the resource consent had been used; and
>
> (c) for which the person is not allowed a deduction under another provision.
>
> *Timing of deduction*
>
> (2) The deduction is allocated to the income year in which—
>
> (a) the person decides not to lodge the application, withdraws the application, or is refused the grant; or
>
> (b) the resource consent lapses or is surrendered.

Link with subpart DA

(3) This section overrides the capital limitation. The general permission and other general limitations still apply.

121. Crucially **s DB 19 does not allow a deduction when the expenditure would not have been part of the cost of depreciable property or otherwise deductible**. This means:

- Section DB 19 applies to the costs of an environmental consent because environmental consents are always capable of being depreciable as depreciable intangible property. This means that if the requirements of s DB 19(1B) are met, a deduction will be available for the cost of the environmental consent.
- The deductibility of expenditure on land consents depends on whether the cost would have been deductible if the project went ahead:
  - There is no deduction under s DB 19 for expenditure on land consents that are not depreciable or deductible (eg, where the land consent is a stand-alone asset or where expenditure is capitalised to land or buildings with an EUL of more than 50 years).
  - Where expenditure on a land consent would have been depreciable as a cost of an item of depreciable property, then a deduction is available (eg, it is a land consent required to construct a swimming pool, retaining walls, fences, roads, dams or any other depreciable land improvement in sch 13). This is because had the consent been granted or used, then the costs would have been deductible or depreciable.

122. Under s DB 19, the deduction is available in the tax year when the person decides not to lodge their application, when the application is rejected, when the consent lapses or when it is surrendered.

Example 4

Wild Coast Electricity Ltd is an electricity generator and retailer. Part of its business involves identifying and developing potential sites. Whether a site is developed depends on a number of factors including the market conditions. The company decides to develop a solar power installation on an empty site it owns in the South Island. The project will require a number of different resource consents.

The company obtains detailed environmental reports that will be used to apply for environmental consents (for waste water and to discharge contaminates during construction) and prepares strategies to mitigate any effects. The company also intends to clear and contour the land to fit as many solar panels as possible onto the site and to maximise the amount of solar energy each panel harnesses. Plans and drawings of the site are obtained and will be used to apply for a land consent for the clearance and contouring of the land.

News of the proposed project leaks and is met with significant local community opposition and unsympathetic media coverage. Some directors also believe the projected levels of electricity generation at the site may have been overstated. For these reasons a decision is made not to lodge the application and to permanently abandon the project.

Environmental consents

Under s DB 19 a deduction is available at the point the directors make the decision not to lodge the application. However, the company can only deduct expenditure that would have been deductible or depreciable. The costs of environmental consents are deductible. This is because environmental consents are depreciable intangible property and the expenditure would have been depreciable had the consents been obtained and used.

Land consents

The plans and drawings were to be used to apply for a land consent for non-depreciable earthworks. For land consents, the operation of s DB 19 depends on the depreciation outcome. The land consent if granted would have been for an unlimited duration and would not have been depreciable property in its own right. While the expenditure could have been capitalised into the cost of the land, there is still no deduction as land is not depreciable property (s EE 7). If the project had gone ahead, the resulting property would not have been depreciable. Therefore, a deduction cannot be taken under s DB 19 for the expenditure.

If the plans and drawings were instead required for an application for a land consent to construct an item of depreciable plant, then the expenditure could have been capitalised to the item of plant and depreciated (if built). In this case a deduction would be available under s DB 19 as the expenditure would otherwise have been allowed as a deduction for depreciation as part of the cost of the item of plant.

Pollution control expenditure

123. Section DB 46 allows a person a deduction for expenditure commonly described as "pollution control expenditure". Broadly, s DB 46 allows a deduction for the expenditure listed in Part A or B of sch 19. Section DB 46 overrides the capital limitation in s DA 2(1) and allows deductions for specified activities that are undertaken to avoid, remedy or mitigate the effects of discharging contaminants. For an expense to be deductible under s DB 46, the taxpayer must:

- carry on a business in New Zealand;
- incur, in the business or the ending of the operations of the business, expenditure that was of a kind listed in sch 19, Part A or B; and
- satisfy the general permission in s DA 1.

124. Section DB 46 only applies where no other provision allows a deduction. The Commentary to the Taxation (Base Maintenance and Miscellaneous Provisions) Bill 2004 identified three ways that taxpayers could claim a tax deduction for environmental expenditure (outside of industry specific provisions):

> - A deduction for normal operating (revenue) expenditure;
> - A deduction under the tax depreciation rules for certain types of capital expenditure, such as tanks, reservoirs, pipes, pumping machinery and screens; and
> - A deduction under section DB 37 (DJ 10) [now s DB 46] for other capital environmental expenditure
>
> Section DJ 10 was introduced to permit business taxpayers a deduction for expenditure incurred **for the purpose of treating industrial waste when no other allowance might otherwise be possible**. It allows business taxpayers to claim a deduction for the cost of constructing on land in New Zealand any earthworks, ponds, settling tanks, or other similar improvements primarily for the purpose of treating industrial waste in order to prevent or combat pollution of the environment. When a deduction is available, it must be spread evenly over five years, beginning with the year in which the expenditure was incurred.
>
> [Emphasis added]

125. Section DB 46 only applies if the amount is not deductible on any other basis. Accordingly, s DB 46 cannot apply to the costs of an environmental consent because these will be depreciable as a cost of an item of depreciable intangible property. Only expenditure on land consents (that would not be otherwise deductible) can be potentially deducted under s DB 46.

126. Section DB 46 allows a deduction for the kind of expenditure listed in Parts A and B of sch 19 but excludes the types of expenditure in Part C. Schedule 19 lists kinds of expenditure relating to avoiding, remedying, or mitigating the detrimental effects of discharging contaminants. The default categories of expenditure are expenditure relating to an activity or improvement to land and expenditure relating to restoration and monitoring. Some examples of the types of expenditure in sch 19 are:

- expenditure, in the construction of an improvement on land in New Zealand, incurred to avoid or mitigate future detrimental effects on the environment from the discharge of a contaminant;
- expenditure on screen planting, on land in New Zealand, incurred in association with the construction of an improvement to the land that is intended to avoid, or mitigate future detrimental effects on the environment from the discharge of a contaminant;
- expenditure related to monitoring the discharge of a contaminant;
- expenditure incurred after the discharge of a contaminant, on avoiding, remedying, or mitigating detrimental effects on the environment from the discharged contaminant;
- expenditure incurred after the discharge of a contaminant, on the installation of impermeable surfaces on land in New Zealand with the purpose of avoiding, remedying, or mitigating detrimental effects on the environment from a discharged contaminant.

127. Subsections DB 46(2)–(8) deal with the timing and calculation of any deduction.

128. In *Waste Management NZ Ltd v CIR* (1995) 17 NZTC 12,147 (CA), the Court of Appeal considered s 124 of the Income Tax Act 1976 (ITA 1976) (an earlier version of s DB 46). Section 124 of the ITA 1976 was worded differently to s DB 46 and did not specify the categories of qualifying expenditure in detail. Richardson J, who delivered the judgment of the Court of Appeal, said that s 124 of the ITA 1976 was an incentive provision designed to encourage improvements to land for the purpose of treating industrial waste to combat pollution. Richardson J also indicated that the section applied where the taxpayer met the criteria prescribed by the subsection, at 12,148:

> **Where the taxpayer meets the criteria prescribed by the subsection** it may spread the expenditure and claim a deduction of one-fifth of the amount in the year in which the expenditure is incurred and in each of the succeeding four years. **The section is an**

incentive provision applying where no other deduction is available and is designed to encourage improvements to land for the purpose of treating industrial waste to prevent or combat pollution.

[Emphasis added]

129. Section DB 46 is only relevant in the small number of cases where expenses incurred in obtaining a resource consent form part of the expenditure under sch 19 and the expenses are not otherwise deductible. It is most likely to be relevant where the:

- cost of the land consent is not depreciable – this means the expenditure is capital in nature and the expenses are neither part of an item of depreciable intangible property nor part of the cost of a resulting item of depreciable property. This is likely to arise in the case of land consents where the resulting asset is a non-depreciable improvement to land (ie, a s 9 RMA consent for earthworks);
- property is not owned by the person incurring the expenditure and so cannot be depreciated by them. Section DB 46 may apply where a land consent is obtained to remedy contamination on a neighbouring property, eg, a land consent obtained to remove contaminated soil from a neighbouring property;
- capital expenditure is incurred in meeting conditions attaching to a resource consent and that expenditure is not depreciable as a cost of the resource consent. Because the cost of the consent is fixed at the point it is ready to use, subsequent expenditure on meeting conditions will usually not be a cost of the consent. An example is a condition attaching to a consent requiring the consent holder to rectify any pollution or contamination of neighbouring properties. This expenditure will not normally be a cost of the resource consent but may be deductible under s DB 46.

Example 5

Cerys runs a haulage business and has specialised tankers that transport various liquids and chemicals. The tankers need to be thoroughly cleaned between jobs and there is specialised cleaning equipment at the depot. On very busy occasions the drains at the depot cannot cope with the volume of water and some excess contaminated water has spilt into an area of native bush on a neighbouring property. Cerys has arranged for extra drainage channels to be created so that in the future any excess water drains away into a lined ditch at the depot. The earthworks involved are significant enough to require a land consent. The expenditure on the land consent is capital (and would not be depreciable because the resulting asset is a non-depreciable land improvement) but is still able to be deducted under a specific provision.

Section DB 46 overrides the capital limitation but not the general permission that must still be satisfied. This is expenditure on the construction of an improvement on land in New Zealand, incurred to avoid or mitigate future detrimental effects on the environment from the discharge of a contaminant, and the works are within sch 19(A)(2). As such, s DB 46 allows the cost of the earthworks (including the land consent) to be deducted and spread in accordance with the section.

Environmental consents

130. Where a taxpayer holds an environmental consent, the cost will usually be depreciable over the fixed life of the consent.

131. Section DA 1 allows a deduction for an amount of expenditure or loss, including depreciation loss, to the extent that the expenditure or loss is incurred in deriving assessable income.

132. Section EE 1 provides that a person has an amount of "depreciation loss" if:

- the person owns a relevant item of property (as described in ss EE 2 to EE 5);
- the item is depreciable property (as described in ss EE 6 to EE 8);
- the item is used or is available for use by the person in the relevant income year; and
- the amount of depreciation loss is calculated under the relevant provisions (ss EE 9 to EE 11).

133. As noted above, from a tax perspective, resource consents available under the RMA can be divided into two general categories; environmental consents and land consents. Section 122(1) of the RMA provides that resource consents are not real or personal property. However, for the purposes of depreciation, the definition of property in the Act includes **all** types of consents granted under the RMA in, or after, the 1997 income tax year. Specifically, s YA 1 defines "property" as follows (as relevant):

property,—

(a) in subpart EE (Depreciation), includes consents granted in or after the 1996-97 tax year under the Resource Management Act 1991:

134. The crucial issue in terms of resource consents is whether they are depreciable property under the legislation. Section EE 6 defines "depreciable property" as:

> *Description*
>
> (1) **Depreciable property** is property that, in normal circumstances, might reasonably be expected to decline in value while it is used or available for use—
>
> (a) in deriving assessable income; or
>
> (b) in carrying on a business for the purpose of deriving assessable income.
>
> Subsections (2) to (4) expand on this subsection
>
> *Property: tangible*
>
> (2) An item of tangible property is depreciable property if—
>
> (a) it is described by subsection (1); and
>
> (b) it is not described by section EE 7.
>
> *Property: intangible*
>
> (3) An item of intangible property is depreciable property if—
>
> (a) it is within the definition of depreciable intangible property; and
>
> (b) it is described by subsection (1); and
>
> (c) it is not described by section EE 7.

135. Intangible property will only be depreciable property if it comes within the definition of depreciable intangible property (s EE 6(3)(a)). The Commissioner considers the best approach to the analysis is to then consider whether the property is depreciable intangible property under s EE 62. The definition of depreciable intangible property is in s EE 62:

> **EE 62 Meaning of depreciable intangible property**
>
> *Meaning*
>
> (1) **Depreciable intangible property** means the property listed in schedule 14 (Depreciable intangible property).
>
> *Criteria for listing in schedule 14*
>
> (2) For property to be listed in schedule 14, the criteria are as follows:
>
> (a) it must be intangible; and
>
> (b) it must have a finite useful life that can be estimated with a reasonable degree of certainty on the date of its acquisition.
>
> *Schedule 14 prevails*
>
> (3) Property that is listed in schedule 14 is depreciable intangible property even if the criteria are not met.

136. Section EE 62(1) limits depreciable intangible property to the items listed in sch 14. Unlike most depreciable **tangible** property, items of **intangible** property must be listed in the schedule to be depreciated. This is not an issue for environmental consents, but it is for land consents, which are intangible property but not listed as depreciable intangible property.

137. Schedule 14(10) includes environmental consents:

> 10 a consent granted under the Resource Management Act 1991 to do something that otherwise would contravene sections 12 to 15B of that Act (other than a consent for a reclamation), being a consent granted in or after—
>
> (a) the 1996–97 tax year, if the consent relates to sections 12 to 15 of that Act; or
>
> (b) the 2014–15 income year, if the consent relates to sections 15A and 15B of that Act

138. Schedule 14 provides that consents removing the restrictions in ss 12–15B of the RMA are depreciable intangible property. Broadly, those restrictions are on the use of coastal marine areas, on uses of beds of lakes and rivers, in relation to water and on the discharge of contaminants. These environmental consents concern resources and under s 123 of the RMA environmental consents have a fixed life of between 5 and 35 years. They are usually expected to depreciate in value over their life. Consents for reclamation are usually of unlimited duration and concern land and are excluded from sch 14.

139. Environmental consents are depreciable intangible property under s EE 62, so the next step is to consider whether they are also depreciable property under s EE 6 and whether they satisfy both ss EE 6(1) and EE 6(3). Intangible property is not subject to wear and tear so will usually only decline in value (as required by s EE 6(1)) if it has a finite life. The Court of Appeal in *Trustpower* made the point that consents require a fixed term to decline in value (at [25]):

> The land use consents of unlimited duration are not within the definition of "depreciable intangible property" because without a fixed term they cannot be "expected to decline in value" over time.

140. Environmental consents are usually granted for a period between 5 and 35 years so will decline in value as required by s EE 6(1). This can be contrasted with land consents that generally have an infinite lifespan and will not therefore be capable of being depreciable property.

141. There are two aspects to s EE 6(1) that need to be satisfied. The environmental consent must be **used or available for use** in **deriving assessable income** (or in carrying on a business for the purpose of deriving assessable income).

142. The Court of Appeal in *Trustpower* (at [27]) considered that the resource consents were "available for use" in that case once they were granted:

> Clearly, once the resource consents were granted, they were "available for use" by Trustpower. The fact that they were not being used and would not be used unless and until Trustpower decided to use them and obtained land access did not mean that they were not "available" for use. The expression "available" simply means "capable of being used". Once Trustpower decided to use them and obtained land access, they would be used. Prior to that they were available for that purpose. [footnote omitted]

143. In this case, even lacking the land access to use the consent did not prevent the resource consent being "available for use" upon grant of the consent. Applying this approach, a resource consent will usually be available to use on being granted. However, in some cases there will be a delay between the grant of the consent and the commencement of the consent under s 116 of the RMA. Section 116 is discussed at [67] of this statement but does not appear to have been relevant in the *Trustpower* litigation. Where there is a difference between commencement and grant, the better view is that the consent is available to use on commencement. This might occur where a resource consent is granted but there is an appeal and it will not commence until the appeal has been resolved.

144. Whether the environmental consent is available for use in **deriving assessable income** is a question of fact. This is equivalent to the nexus requirement under s DA 1. The Supreme Court in *Trustpower* accepted that the "expenditure was incurred by Trustpower in the course of carrying on its existing business as a generator and retailer of electricity, a business which it carries on for the purpose of deriving assessable income". The Court of Appeal took a contrary view on nexus (under s DA 1 rather than s EE 6). Its view was Trustpower's profit-making enterprise was the generation and retailing of electricity, not the development of possible new projects and applications for resource consents for those projects. While the Supreme Court took a different approach, this highlights the importance of nexus to deriving income, particularly with new projects not yet part of the profit-making enterprise.

145. On new projects, any expenditure incurred before the establishment of a business or an income-earning activity will not fulfil the statutory nexus, because the expenditure will have been incurred too soon. The Commissioner's view on the commencement of a business or an income-earning activity is set out in IS 17/01 (at [29]–[106]). In summary:

- The decision as to whether a business or an income-earning activity has commenced is one of fact and degree. Four factors are relevant:
  - It is critical to determine the true nature of the business.
  - A commitment must have been made to enter into that business.
  - The required profit-making structure for the particular business must be in place.
  - The ordinary current operations of the business must have begun.

146. This is particularly relevant to resource consents because an application for a consent may precede both the profit-making structure being in place and the start of the ordinary current operations of the business.

147. Any resource consents obtained for private or domestic purposes (eg, consents relating to private dwellings) will not be available for use in deriving income or carrying on a business for deriving income. Consequently, such consents will not be depreciable property under s EE 6.

Examples 6, 7, 8 and 9

Example 6: Nexus with income required

Dave and Barbara own a home on the banks of the Brockhampton River, close to where the river meets the sea. They are avid boaties and want to install a floating pontoon on the river. They check with the council and are told they require an environmental consent for the floating pontoon. In the future, Dave wants to retire from his job as a mid-ranking civil servant and run fishing and boat charters from the pontoon.

The environmental consent is not depreciable property because the consent is not used in deriving assessable income. Despite Dave's future intention, the use is private.

INTERPRETATION STATEMENTS

Example 7: Nexus with income established

Incin-a-lot Ltd provides services collecting and incinerating waste. The company has been successful and wants to offer a new service incinerating medical waste. It intends to build an additional incinerator at its existing premises for this purpose. To operate the new incinerator, it requires an environmental consent under s 15 of the RMA allowing the discharge of contaminants into the atmosphere.

The council grants a s 15 resource consent with a 25-year term. The environmental consent is depreciable property because there is sufficient nexus with deriving assessable income. The consent is used in carrying on a business for the purpose of deriving assessable income.

Example 8: Preliminary expenditure

Costco have carried on a successful business for many years selling household products. Costco purchased some vacant land intending to develop another retail outlet, but current market conditions are unfavourable, so Costco has been looking at alternative uses for the land. The tourism industry is booming in the region and Costco have identified a need for more budget accommodation in the city, so seek consents to construct and operate a hotel on its land.

Following extensive opposition to the proposal, Costco withdraws its application for consent. The expenditure will not be deductible because Costco was not in the hotel business when the expenditure was incurred.

Example 9: Preliminary expenditure

Dave runs a company that operates a successful gym franchise. Dave has purchased some vacant land and wants to turn it into another gym. However, a competitor has opened up nearby and Dave decides the current market conditions are unfavourable, so is considering a different business use for the land. He already sells a limited range of sports goods at the gym (energy bars, drinks bottles, towels, yoga mats, weight-lifting accessories etc) and thinks he could expand this side of the business by using the land to open a retail outlet selling sports gear. He applies for a resource consent to build and operate the store.

Following extensive opposition to the proposal from existing sports gear retailers, Dave withdraws the company's application for consent. The expenditure on the withdrawn consent will be deductible under s DB 19 because retailing of sports gear has sufficient connection with his existing business.

148. In terms of tax treatment, environmental consents are depreciable as items of fixed life intangible property. "Fixed life intangible property" is "depreciable intangible property" that has a legal life that could reasonably be expected, on the date of acquisition, to be the same length as the property's remaining EUL (s EE 67). The legal life of environmental consents is between 5 and 35 years and will usually be the same as the EUL.

149. Section EE 33 provides for the annual rate of depreciation for "fixed life intangible property". The annual rate is calculated using the formula:

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

150. As environmental consents are items of fixed life intangible property under sch 14, they must be depreciated using the straight-line method (s EE 12(2)(b)(ii)). This spreads the cost (as determined above from [39]) of the environmental consent over its legal life.

151. To the extent that an environmental consent is unused taxpayers can surrender the consent (s 138 of the RMA) and claim a deduction under s DB 19. This is discussed at [119].

Environmental consents are treated as separate assets for depreciation

152. Environmental consents would often be inseparable from the asset to which they relate (as happened in *Milburn*, which predates sch 14 and *Trustpower HC* which did not apply sch 14). However, the impact of sch 14 is that environmental consents are **treated** as separate assets for depreciation purposes.

153. This raises the question of whether the costs of an environmental consent must always be depreciated as separate items of depreciable intangible property. The Commissioner's view is that sch 14 is a code for items of depreciable intangible property. Environmental consents are specifically included in sch 14 and they are granted for fixed periods. The Commissioner's view is that Parliament intended (for depreciation purposes) environmental consents to be treated as stand-alone items of depreciable intangible property, which are depreciable according to their own legal life, rather than according to the estimated useful life of any other depreciable items to which they may relate.

Conclusion for environmental consents

154. In summary, environmental consents are:

- separately listed in sch 14; and
- depreciated according to their legal life, rather than according to the estimated useful life of any items to which they may relate.

Example 10

Incin-a-lot Ltd is building an additional incinerator for medical waste. The council has granted Incin-a-lot Ltd a 25-year environmental consent to discharge contaminants into the atmosphere from this incinerator. The consent cost is $50,000, including legal fees, application fees, design and engineering reports, scientific reports and an environmental report. The costs of the environmental consent are depreciated over the legal life on a straight-line basis. This means the cost of $50,000 is depreciated over a 25-year period resulting in a straight-line depreciation deduction of $2,000 a year.

However, developing contracts with customers has been slower than expected and the new incinerator will not be put into operation until next year. Further, due to high operating temperatures, this kind of incinerator only has a 10-year useful life. Does this change how the costs are depreciated?

No. The environmental consent can be depreciated from the point where the consent is available to be used. It is available to use and the costs are depreciable, despite the incinerator not actually being used until the following year. The incinerator's shorter useful life does not affect the environmental consent. The environmental consent should be depreciated as a separate item of depreciable intangible property over its fixed term. Incin-a-lot Ltd may wish to surrender the environmental consent once the incinerator is no longer in use and write off the remaining amount of the un-depreciated cost of the consent.

Land consents

155. The deductibility of the expenditure for land consents is highly fact-dependent:

- In exceptional circumstances a land consent **may be depreciable as a right to use land** under sch 14(5). In this case the treatment is the same as for environmental consents (see from [131]).
- Expenditure on land consents **may be capitalised to the cost of a resulting item of depreciable property**. In this case the costs are depreciable at the rate that applies to the resulting item of property (note that buildings generally depreciate at 0%).

Land consents depreciable as a right to use land

156. Like environmental consents, to be depreciable land consents must meet the criteria in s EE 6 (at [134] above). Section EE 6(3)(a) provides that intangible property will be depreciable property if it is within the definition of depreciable intangible property:

Property: intangible

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

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

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

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

157. This means the first step is that land consents need to be depreciable intangible property under s EE 62. Section EE 62 defines depreciable intangible property as the property listed in sch 14, that includes:

5 the right to use land

...

10 a consent granted under the Resource Management Act 1991 to do something that otherwise would contravene sections 12 to 15B of that Act (other than a consent for a reclamation), being a consent granted in or after—

(a) the 1996–97 tax year, if the consent relates to sections 12 to 15 of that Act; or

(b) the 2014–15 income year, if the consent relates to sections 15A and 15B of that Act

INTERPRETATION STATEMENTS

158. While environmental consents are listed in sch 14(10), land consents are not. However, it is possible some consents could come within sch 14(5). As discussed below, the Commissioner's view is that while it is possible that a land consent could be a right to use land, this is unlikely to occur very often. Outside of sch 14, there is no ability under the Act to depreciate intangible property (as a stand-alone item of property).

A right to use land as depreciable intangible property in sch 14(5)

159. Land consents can be depreciated as stand-alone items of depreciable intangible property if they are a "right to use land" under sch 14(5) and depreciable property under s EE 6. "Land" is defined broadly in s YA 1, as including any estate or interest in land, and an option to acquire land or an estate or interest in land, but does not include a mortgage.

160. The meaning of a "right to use land" in sch 14 is discussed in *ANZCO Foods Ltd v CIR* [2016] NZHC 1015, (2016) 27 NZTC 22-049. The High Court considered whether a "right to use land" was a separate item of depreciable intangible property or merely part of the inherent rights of fee simple ownership. ANZCO purchased a meat processing plant that had previously been owned by a competitor. When the competitor sold the plant to a third party they had included a covenant preventing certain meat processing activities for a period of 20 years. An encumbrance was registered against the title. Subsequently, ANZCO purchased the property and the competitor considered they were breaching the terms of the encumbrance and commenced legal proceedings. Ultimately, a settlement was reached whereby ANZCO paid the competitor $5.6m and in return the encumbrance was altered to allow the meat processing activities in question. The settlement deed recorded this as being a grant of a right to use land from the competitor to ANZCO. ANZCO depreciated the $5.6m as a cost of the right to use land under sch 14. The Commissioner did not accept that there was a right to use land under sch 14.

161. In *ANZCO*, Mander J specifically considered the meaning of the term "right to use land". Mander J considered a "right to use land" under sch 14 refers to:

- rights that have a finite life; and
- rights to use land that are not part of the inherent ownership of the fee simple estate.

Right to use land must have a finite life

162. Section EE 62 reads:

> *Criteria for listing in schedule 14*
>
> (2) For property to be listed in schedule 14, the criteria are as follows:
>
> (a) it must be intangible; and
>
> (b) it must have a finite useful life that can be estimated with a reasonable degree of certainty on the date of its acquisition.
>
> *Schedule 14 prevails*
>
> (3) Property that is listed in schedule 14 is depreciable intangible property even if the criteria are not met.

163. On the face of it there is an argument that subsection (3) means a right to use land does not have to have a finite life to be depreciable intangible property (although it would still need to decline in value under s EE 6). This approach was not adopted in *ANZCO*:

> **[96] The "right to use land" as that term is used in sch 14, must be read in its statutory context – the objective of the Act, and in particular the purpose for which sch 14 was provided. The statutory intent of the criteria used in s EE 62 was to limit the interpretation of items of intangible property listed in the schedule to those that depreciate. This is consistent with the statutory purpose of the legislation to allow a deduction for an item of property used in deriving assessable income which declines in value over a finite period.**
>
> [97] In *Commissioner of Inland Revenue v Trustpower Limited [Trustpower]* the Court of Appeal considered the depreciation regime provided by the Act. The case concerned deductions for expenditure incurred in the acquisition of various resource management consents. The consents included land use consents, water permits and discharge permits. The land use consents were for an unlimited duration, whereas the other permits were for fixed periods and would expire after a number of years.
>
> [98] The predecessor to the current regime, sch 17, also listed consents granted under the Resource Management Act 1991 as items of depreciable intangible property. In considering whether resource consents, as that term is described without qualification in the schedule, were intangible depreciable property, the Court of Appeal distinguished between the land use consents which were for an unlimited duration and the water and discharge permits which had been granted for fixed periods. The Court held:
>
> > [25] In the case of intangible property, this provision [section EE 6] will apply if the three requirements of s EE 6(3) are met. As the cl 9 resource consents are "depreciable intangible property", the first requirement is met. The land use consents of unlimited duration are not within the definition of "depreciable intangible property" because without a fixed term they cannot be "expected to decline in value" over time.

INTERPRETATION STATEMENTS

> [99] The approach taken by the Court of Appeal demonstrates that **notwithstanding s EE 62(3), which provides that property listed in the schedule is depreciable intangible property even if the criteria are not met, the meaning of items listed in the schedule are still to be interpreted in accordance with the criteria provided in subs (2)**. Because the land use consents were not subject to any fixed term it was accepted they could not be expected to decline in value. That finding may be viewed as an amalgam of the criterion in s EE 62(2)(b) and the qualifying description of depreciable property in s EE 6(1), but **the effect is the same; intangible depreciable property cannot include property that does not have a limited useful life**.
>
> [Emphasis added and footnote omitted]

164. In summary, the "right to use land", must be read in its statutory context – the objective of the Act and its purpose. The High Court considered the intent of the criteria in s EE 62 is to limit the interpretation of items of intangible property listed in the schedule to those that depreciate. Further the purpose for which sch 14 was provided is to provide a deduction over time for an item of property used in deriving assessable income that declines in value over a finite period. The High Court notes that the finding in *Trustpower* was an amalgam of ss EE 6(1) (the property must decline in value) and EE 62 (the property must have a finite life) but the effect is the same and intangible depreciable property cannot include property that does not have a limited useful life.

165. The approach adopted in *ANZCO* requires a land consent to have a finite life to be depreciable intangible property. This approach is consistent with *Trustees in the CB Simkin Trust and the Trustees in the NC Simkin Trust v CIR* (2005) 22 NZTC 19,001, where the Privy Council (at [8]) were concerned with the predecessor of s EE 62 and considered that the types of intangible property in sch 14 were distinguished by the longevity of their useful lives.

Right to use land not part of inherent ownership of fee simple

166. Mander J's conclusion in *ANZCO* is that a right to use land in sch 14 does not extend to include rights which form part of the ownership of the fee simple estate:

> [108] **The meaning of a "right to use land" as listed in sch 14 as depreciable intangible property does not extend to include rights which form part of the ownership of the fee simple estate**. The rights to use the land which became available to ANZCO as a result of the settlement do not have a finite useful life over which they will depreciate. As a consequence the payment made by ANZCO to obtain the variation of the encumbrance in order to access those rights reflects the increased capital value of the property in the hands of the owner.
>
> [Emphasis added]

167. Mander J draws a clear distinction between the rights of the owner and the right of use, relying on the Court of Appeal's decision in T*rustees of the CB Simkin Trust and the Trustees in the NC Simkin Trust v CIR* (2003) 21 NZTC 18,117 (which was upheld by the Privy Council on appeal). The case concerned the meaning of "the right to use a trademark" in sch 17 of the Income Tax Act 1994 (a predecessor to sch 14) rather than the "right to use land". Gault J, delivering the decision of the Court, undertook a comprehensive analysis of the scheme of what was sch 17 (now sch 14). Specifically addressing a right to use land, Gault J considered the right to use land is clearly limited to rights distinguishable from right of use inherent in the ownership of the tangible property itself.

168. In *ANZCO*, the removal of an encumbrance was found to be the return of the inherent rights of ownership and not a right to use land under sch 14. Mander J discusses at [91]–[93] how some rights to use land are rights inherent to the ownership of the land. In that case, the competitor had the benefit of the encumbrance but it never acquired any right to use the land, only a right to prevent the owner from using it. The right to use the land was with ANZCO at all times.

169. Where a right to use land has been recognised by courts this has been in the context in which the term is usually understood, ie, a right to physically access land you do not own for a particular purpose. For instance, in *Ben Nevis Forestry Ventures Ltd v CIR* [2008] NZSC 115, [2009] 2 NZLR 289, one aspect of the structure that was ultimately held to be tax avoidance involved the forestry investors being granted a licence to use land for approximately 50 years to grow trees. However, the Supreme Court concluded that absent the tax avoidance conclusion, the licence to use the land for forestry purposes was a right to use land under sch 14 (at [54]).

Whether a land consent is a right to use land

170. If a land consent is to be a right to use land under sch 14(5), the first hurdle is that it has a finite life. The second hurdle is that it must be a right to use land separate from the rights of inherent ownership, that is, it is not a right obtained through ownership of the land.

171. Land consents will generally not be a right to use land under sch 14 because land consents are usually granted for an unlimited duration (s 123 of the RMA) and so do not have a finite life (part of the criteria in s EE 62(2)). The Court of Appeal confirmed this point in *Trustpower* (at [25]) in relation to resource consents, considering that land use consents of unlimited duration are not within sch 14:

> As the cl 9 [now cl 10] resource consents are "depreciable intangible property", the first requirement is met. **The land use consents of unlimited duration are not within the definition of "depreciable intangible property" because without a fixed term they cannot be "expected to decline in value" over time**.
>
> [Emphasis added]

172. Even if a land consent has a finite life, it still needs to be a right to use land. The RMA prevents people from subdividing property and doing anything contrary to the district plan. Land consents are by default infinite rights (s 123 of the RMA) that attach to the land (s 134 of the RMA). Because they attach to the land they can be used by any owner and cannot be transferred separately from the land. Sections 9 and 11 of the RMA are drafted in a way that restrict certain inherent rights of property ownership and a consent will remove that fetter on ownership rather than create a new and separate right to use land. In most cases where a land owner obtains a land consent (say to build a certain distance from the boundary or to build a three-storey property) they are having rights returned to them that become indistinguishable from the inherent rights of ownership of the land.

173. However, there may be instances where a land consent is a right to use land and has a finite life. This might be the case where the person does not own the relevant property, ie, they may be granted a licence to access the land for a particular purpose. For instance, time-limited land consents may be granted for concert performances, carnivals on the beach, flea markets in car parks, street parades and temporary events. This issue could also arise in relation to land consents for reclamation of seabed, foreshore, rivers and lakes (or using them in a way that is contrary to a district plan) as the person seeking the land consent may not have any rights of ownership in respect of the land. However, these land consents would need to be time-limited to be a depreciable right to use land.

174. If a land consent is a right to use land under sch 14, then it is depreciable intangible property. The costs are depreciable by reference to their fixed life in the same way as environmental consents. However, depending on the circumstances, some time-limited consents may be deductible as revenue expenditure. This may arise where a land consent is granted for a one-off event or a short duration and so provides no enduring benefit.

Conclusion on a right to use land under schedule 14

175. In conclusion, there is limited scope for land consents to be a right to use land under sch 14. This is restricted to rare circumstances where the consents:
    - are granted for a finite duration; and
    - give rise to a right to use land, meaning it must be a right to use exercised independently from the rights of ownership, ie, fee simple owners will not usually have a separate right to use.

Land consent expenditure capitalised into other depreciable property

176. While most land consents are unlikely to be depreciable as depreciable intangible property under sch 14, expenditure on land consents may be capitalised into the cost of a resulting item of property. However, where this is not possible there will be no depreciation deduction. Whether expenditure on a land consent is a cost of another item of property depends on the terms of the consent and the relationship to the property. To be included in the cost of another item of depreciable property the expenditure must satisfy the general principles in relation to cost, discussed above from [39].

177. It seems generally well accepted that expenditure on a land consent can be capitalised into the cost of a resulting asset. The Officials' Report on the Taxation (Miscellaneous Issues) Bill 1995 discusses the tax treatment of land use consents:

> **Issue: Cost of land use resource management consents**
>
> **Clause 62**
>
> **Submission**
>
> > (43 - New Zealand Society of Accountants; 37W - Mercury Energy)
> >
> > Where land use consents that have an infinite life relate to the erection of a structure their cost should be added to the cost of the structure and depreciated.
> >
> > Comment
> >
> > The bill allows depreciation of fixed-life resource management consents. In relation to land use consents that have an infinite life, it was announced in the Commentary on the Bill that Inland Revenue considered that, where such consents relate to the erection of a structure, they have a finite useful life that is the life of the structure. **Inland Revenue is therefore currently working on a *Tax Information Bulletin* item that proposes that, for depreciation purposes, the cost of land use consents that pertain to the erection of a structure should be included in the cost of the structure. Mercury and the New Zealand Society of Accountants note that this policy is both logical and appropriate and is fully endorsed by them**. The submission does not seek an amendment to the legislation.
>
> [Emphasis added]

INTERPRETATION STATEMENTS

178. The commentary relating to the introduction and amendment of s DB 13B (now s DB 19 and discussed above from [119]) contains comments about the correct tax treatment of land use consents. The reasoning behind the insertion of s DB 13B by the Taxation (Venture Capital and Miscellaneous Provisions) Act 2004 was explained in *Tax Information Bulletin* Vol 17, No 1 (February 2005) as follows:

> A new section DJ 14B has also been added to the Income Tax Act 1994 and new section DB 13B to the 2004 Act to allow deductibility for costs associated with resource management consent applications that are not granted or are withdrawn. Again, the costs that are deductible are those that would have been part of the cost of a resource consent (for depreciation purposes) if the application had been granted. On the recommendation of the Finance and Expenditure Committee, the **change applies to both resource consent applications that, if successful, would have resulted in consents with a fixed legal life (fixed life intangible property) as well as non-fixed life consents that would nevertheless have been depreciable by other means (for example, included in the cost of a building or other structures)**.

[Emphasis added]

179. Allowing expenditure on a land consent to be added to the cost of the resulting asset, to which it is directly attributable, recognises that the consent's useful life is not unlimited but mirrors that of the asset. For instance, if a resource consent is granted based on plans to permit a building to extend beyond the building envelope, then in most instances once that building has been completed the resource consent has no further utility. It continues to exist but is inseparable from the building. In these circumstances, it would be unrealistic to say it has an infinite life separate from the building. Where the useful life of a land consent does not correspond to that of a particular asset, it suggests that the resource consent should not be capitalised to the cost of the asset.

180. In the majority of cases the resulting asset will be obvious (eg, if a land consent is obtained for the construction of a road, then the asset is the road). Where consents potentially relate to more than one asset, an issue arises as to how the expenditure should be allocated.

Allocating the cost between items of property

181. On large infrastructure projects there could conceivably be improvements to land, new roads and access ways, hardstanding, plant, structures and buildings. Identifying the correct resulting items of depreciable property will have significant implications for taxpayers because some items will not depreciate at all (eg, land) and other items will depreciate at varying rates.

182. Where there is expenditure on a land consent, it is first necessary to identify the various items of property for depreciation purposes that the consent relates to. Allocating the cost of a land consent will be possible once the item of depreciable property is clearly identified. The general principles in determining "cost" are discussed above from [39]. In short, the cost of an asset includes expenditure that must be incurred to acquire it. This requirement is determined by reference to the commercial reality, with consideration given to standard business practice and what is commercially required to obtain the asset. Case law allows standard accounting practice to be used in interpreting cost. In the accounting standards, construction costs are generally included in the cost of an asset along with any costs directly attributable to bringing the asset to the location and condition necessary to operate it.

183. If a land consent is required for the construction of an asset it will be directly attributable to that asset. The requirements under district plans vary from place to place but the construction of many buildings and structures will require resource consents. In these cases a consent will be obtained based on plans or specifications to build a structure to a certain height, at a certain location or to undertake specific commercial or industrial uses. In these circumstances, expenditure on a land resource consent will likely be part of the cost base of the structure.

184. Resource consent expenditure may be incurred in circumstances where it is not directly attributable to a single item of property. Where that is the case, the Commissioner will require apportionment of the expenditure on a reasonable basis between the items of property. The exact nature of any apportionment will depend on the facts.

185. Sometimes a condition of a resource consent will require the consent holder to construct another asset (see Example 11) that will require further "sub-consents". The first step is to identify the items of property for depreciation purposes. If the new asset is functionally and physical distinct from the existing assets, it is likely to be a separate item of property for depreciation purposes. Because the sub-consent was required for the construction of the new asset it is likely to be a cost of the new asset.

Treatment of different property

Land

186. Land is not depreciable property (s EE 7) because it usually appreciates in value. Where the resulting item is land, expenditure on a land consent directly attributable to the land will not be depreciable.

187. In *Queenstown Airport Corporation Ltd v CIR* [2017] NZCA 20, (2017) 28 NZTC 23-002 the Court of Appeal considered that contouring, levelling, draining, excavation, filling and reclamation were inseparable from the underlying land and not likely to be subject to loss in value due to wear and tear or obsolescence:

> [46] Land (apart from certain specified land improvements) is not depreciable because, unlike other assets, it does not have a determinate design life after which replacement in whole or in part is expected to be necessary. Nor is it expected to decline in value over time through ordinary wear and tear.
>
> [47] The text of the ITA makes it clear that the items listed as improvements in schedule 13 are exceptions to the general rule that land is not depreciable. There is nothing to suggest Parliament intended that the generous approach advocated by the appellant should be adopted in interpreting the specified items. The structure of the relevant provisions does not support this. Rather, Parliament has chosen to specify the items it has concluded are to be treated as exceptions to the general prohibition on the depreciation of land.
>
> [48] The analysis in the 1992 officials' paper we have set out above is helpful in identifying two relevant categories of land improvements. The first is improvements to the land itself such as contouring, levelling, draining, excavation, filling, reclaiming and making retaining walls. These were considered to be inseparable from the land and not likely to be subject to loss in value due to wear and tear or obsolescence. The second category comprises structures or other additions to the land itself that were considered likely to diminish in value over time due to fair wear and tear. The examples given were fences, dams, cables and bridges. Since it was considered this category would be difficult to define, the list approach was prepared and adopted.
>
> [49] The items listed in schedule 13 clearly reflect this approach and may be regarded as improvements or additions on or under the land itself. The items listed are likely to be subject to fair wear and tear such that they would ultimately require replacement in whole or in part during their anticipated design life. [footnotes omitted]

188. Accordingly, where a land consent is obtained for improvements to the land itself, such as contouring, levelling, draining, excavation, filling and reclamation, expenditure on the consent will not be depreciable. This is because the expenditure is directly attributable to the land, which is not depreciable property.

189. However, expenditure on land consents for contouring, levelling, draining, excavation, filling and reclamation can still be depreciable where it forms part of the cost of a resulting item of depreciable property that is not land. This might be the case where, for example, a land consent is obtained to excavate foundations for a structure that is depreciable. The land and foundations are not physically or functionally distinct from the structure. Accordingly, the resulting item of property for depreciation purposes is the structure. This treatment recognises that where land is altered to accommodate a structure (eg, excavations for foundations), the altered land and the structure will often have a similar useful life.

190. In summary, where the resulting asset is land, expenditure on land consents will not be depreciable. This may apply to consents for reclamation, earthworks, drainage, levelling or contouring. Similarly, subdivision consents will usually create an asset that is land, in which case there will be no depreciation (although expenditure on subdivision consents may be a cost of revenue account property and deductible this way).

Buildings

191. From the 2011–12 income year, the depreciation rate for buildings with an EUL of 50 years or more is 0%. Accordingly, where expenditure incurred to obtain a land consent forms part of the cost of a building of this type there will be no depreciation deduction.

192. An example would be where a land consent is required under the district plan to construct a building (with an EUL of 50 years or more) within a certain distance of the boundary or to a certain height. Expenditure on the consent can be capitalised into the cost base of the building but because the building depreciates at 0% there is no deduction.

Schedule 13 depreciable improvements to land

193. In *Queenstown Airport* the Court of Appeal differentiated between improvements to the land (not depreciable) and improvements on the land (the items listed in sch 13 and depreciable). Expenditure incurred to obtain a land consent required to construct any of the items listed in sch 13 (eg, airport runways, dams, swimming pools, roads, fences) will be depreciable as such expenditure forms part of the cost of the item.

Other depreciable property

194. Where a land consent is required to construct or operate an item of depreciable property, the expenditure may form part of the cost of the item of depreciable property. Provided the consent has sufficient connection to be a cost of the asset it can be capitalised into the cost base of the asset and depreciated at the rate that applies to that item.

Further examples

195. The following further examples are included to assist in explaining the application of the general principles outlined in this statement. Example 13 is based on the lifecycle of an infrastructure project and focuses on a number of narrow issues and principles. Consequently, this is a simplification of what happens on infrastructure projects and the example assumes that the consent is only for the turbines and the example does not address different items of depreciable property nor different depreciation rates.

Examples

Example 11 – Expenditure on two land consents

Incin-a-lot Ltd obtains a land consent to build a new chimney at their existing premises. It needs a land consent because the district plan places a restriction on building structures over a certain height. The expenditure on the land consent forms part of the cost of the chimney, which is an item of depreciable property. Consequently, the company can add the expenditure on the land consent to the cost of the chimney and depreciate it at the applicable rate.

As a condition of the resource consent, the council requires Incin-a-lot Ltd to build an earth wall close to the state highway so that the new chimney is less visible from the road. The earth wall requires a land consent for the earthworks and contouring.

The expenditure on the resource consent for the earth wall cannot be allocated to the cost of the chimney. The earth wall is functionally and physically distinct from the chimney. Expenditure to obtain the land consent is directly attributable to the earth wall. That means that expenditure on the land consent is capitalised into the cost of the earth wall.

Example 12 – Land improvement or asset constructed on land

Dave and Barbara's charter boat business (see Example 6) has been so successful they now have a number of boats and employees. Their floating pontoon is no longer big enough for their business. They want to replace the floating pontoon with a large modern wharf.

As part of the construction they must reclaim a strip of land at the water's edge. This will strengthen the estuary bank to allow heavy construction vehicles to be used in the construction of the wharf. Amongst other things these vehicles are required to drive the supporting structure into the estuary bed. After construction the reclaimed land will be used as a picnic area for Dave and Barbara's customers and staff.

A reclamation consent is a type of land consent and not depreciable property. However, expenditure on land consents can potentially be part of the cost of the resulting item of property. Proper identification of the resulting asset is important because if the expenditure is part of the cost base of the wharf it is depreciable (wharves are depreciable under sch 13). If the expenditure is a cost of a non-depreciable land improvement (that is obtaining the reclaimed land) then there will be no depreciation deduction.

Judgement is required to determine whether improvements to land should be part of the cost of the land or part of the cost of some other asset constructed on the land. It may depend on the nature and extent of the land improvements. In this particular case the wharf and the reclaimed land are distinct items of property. The wharf structure is built into the estuary bed not the reclaimed land. Functionally the reclaimed land and the wharf also serve different purposes. There are two items of property and the reclamation consent is directly attributable to the reclaimed land and not the wharf. Consequentially the expenditure is not depreciable.

Example 13 – Major infrastructure project

After the failure of its solar energy plant, Wild Coast Electricity Ltd (see Example 4) is searching for new wind power sites.

Wild Coast Electricity engages a contractor to monitor wind readings at numerous sites across the Lower North Island. The contractor accesses the sites and prepares a report comparing the wind readings and suitability of the sites. The expenditure is not directed towards making tangible progress on a specific capital project. The cost of the report and amounts paid to farmers for site access are deductible under the principles in IS 17/01: "Income tax – deductibility of feasibility expenditure".

Based on the contractor's recommendation, Wild Coast Electricity decides to go ahead and develop three sites in the Wairarapa, that they name Rimu, Kowhai and Kauri. Wild Coast Electricity wants to apply for land consents to erect wind turbines on the sites and commissions detailed environmental reports, drawings showing the placement of the turbines and an engineering report that contains all the specifications for the model of turbine being used. The reports will be used as part of the application.

Rimu site

The environmental report for Rimu shows that the site is close to the habitat of the Waiohine Robin, an endangered native species. A local volunteer group has been set up to protect the robins. They monitor bird numbers and set traps for predators. Although there are only a dozen volunteers they have a decent following on social media. The company gets an opinion from a specialist resource consent lawyer who believes the proximity of the Waiohine robin means it is 50/50 as to whether they will be granted resource consent. Costly mitigation strategies and additional legal costs are certain to affect the profitability. Wild Coast Electricity also thinks it will be a reputation risk and decides not to lodge an application for resource consent.

Expenditure on obtaining a land consent for the construction and use of the turbines would have been able to be capitalised into the cost of the wind turbines and depreciated if the development went ahead. On this basis, s DB 19 allows a deduction once the company decides not to proceed with the development. The expenditure on the environmental report, drawings and legal fees can all be deducted under s DB 19. The engineering report is specific to the model of turbine and the report was to be used for the resource consent applications at all three sites. As the same engineering report will be used for the resource consent application at the other sites it is not appropriate to deduct the entire cost. In these circumstances a reasonable approach is an apportionment of a third to each site. However, a reasonable apportionment on some other basis may also be acceptable, for instance, in some circumstances it might be more reasonable to apportion the expenditure based on the expected number of turbines at each site.

Kowhai site

At the Kowhai site, access is over a farmer's land and Wild Coast Electricity decides it wants an initial five-year easement. Wild Coast Electricity negotiates with the farmer for an easement and one of the conditions of the easement is that the company will put in a short single-lane metalled road over the farmer's land that they will use for egress. They pay the farmer $15,000 for the grant of the easement and laying the metalled road costs a further $10,000. The easement is a right to use land under sch 14(5) and is depreciable over its fixed life. The metalled road is not owned by Wild Coast Electricity but is part of the cost of the right to use land and so can be capitalised to that easement and depreciated.

Kauri site

The development of the Kauri site looks promising. However, one close neighbour is a rural school. The resource consent specialist lawyer advises that without the school's agreement the resource consent application is likely to end up in a contested Environment Court hearing. If opposed by the school, it will cost the company significantly more and there is a strong possibility resource consent would be blocked. Even if resource consent was granted the conditions imposed could make the development un-commercial. The school and Wild Coast Electricity enter into an agreement where the school will support the granting of the resource consent. In return, Wild Coast Electricity will build a new school playground away from any development on the other side of the school. Wild Coast Electricity goes ahead and builds the new playground at a cost of $25,000 and wants to know how this expenditure is treated for tax purposes.

To be deductible or depreciable the expenditure must be either deductible under the general permission, deductible under a specific provision in the Act or able to be capitalised into the cost of depreciable property owned by the company.

To determine whether the expenditure is capital or revenue in nature it is necessary to apply the principles in *Trustpower* (and other case law), including considering the need or occasion giving rise to the expenditure. In this case, the need or occasion of the expenditure is to obtain the school's agreement (or agreement not to object) to the resource consent for building the Kauri windfarm on terms that are commercially viable. The Kauri windfarm will be part of and extend Wild Coast Electricity's capital structure. On these facts, the Commissioner considers the expenditure is capital in nature as it is a one-off cost incurred to expand Wild Coast Electricity's capital structure. In this case the expenditure is not deductible under the general permission as it is capital.

Where a taxpayer incurs capital expenditure on obtaining an item of property they would usually capitalise this to the cost of the property and (assuming it is depreciable property) depreciate the cost. The playground is not owned by Wild Coast Electricity and cannot be depreciated by it. A depreciation deduction is only available to the extent that the expenditure is a "cost" of an item of depreciable property owned by Wild Coast Electricity.

The case law says a cost is "that which must be given in order to acquire something". A transaction must be viewed in its commercial reality and assistance may be derived from common business practice. In this particular circumstance, the commercial reality is that the expenditure incurred under the agreement with the school is necessary to obtain the resource consent. On these facts the expenditure is directly attributable to the consent. The purpose of the expenditure incurred on building the playground is to acquire the consent and Wild Coast Electricity did not obtain any other property or asset to which the expenditure could be attributed. The expenditure is also necessary, proportionate and has a temporal relationship with obtaining the consent. Whether expenditure is a "cost" of an item of property will depend on the particular facts, but in this instance the $25,000 is expenditure that is a cost of obtaining the land consent to build the wind turbines.

Kowhai site stalled

The market conditions are such that a single development at the Kauri site will be sufficient to meet current demand, so Wild Coast Electricity decides to stall any development of the Kowhai site for the time being. A deduction under s DB 19 for expenses for the various reports for the Kowhai site is not available at this point because the project is stalled rather than abandoned.

In the meantime, Wild Coast Electricity wants to store equipment at the Kowhai site. The site is logistically important to Wild Coast Electricity's long-term operations and is also close to the Kauri site. Wild Coast Electricity applies for a land consent for a storage building. The consent is granted and a building with a useful life of more than 50 years is constructed. The expenditure on the land consent can be capitalised to the cost base of the building but in this case the depreciation rate is 0%.

Consent obtained for Kauri site

With the school's support, land consent for the construction of the wind turbines at the Kauri site is granted. The consent is not depreciable as a stand-alone asset, has an unlimited duration and is not depreciable property that has a fixed legal life. However, the expenditure on obtaining the consent can be capitalised into the cost of the turbines and depreciated at the rate that applies to the turbines.

One of the conditions imposed on the resource consent is that Wild Coast Electricity must monitor and keep a record of all bird strikes for the life of the turbines. As part of this, it must also provide an email address that members of the public can contact to report any hurt or dead birds. Expenditure on monitoring bird strikes is an ongoing and recurring part of Wild Coast Electricity's business. It provides no enduring benefit. For Wild Coast Electricity, this sort of expenditure is revenue in nature as it is an ordinary incident of business and is therefore deductible.

Kauri site expansion

After a couple of years, Wild Coast Electricity successfully negotiates the purchase of land adjoining the Kauri site from a farmer. Wild Coast Electricity applies for a new resource consent for stage 2, which will involve adding additional wind turbines. In applying for a new resource consent, Wild Coast Electricity reuses some of the reports from the previous application. The expenditure incurred on these reports has already been capitalised and depreciated. The reports were obtained and used specifically for the resource consent applications for stage 1 and in this circumstance it is appropriate that the entire expenditure is allocated as a cost of stage 1. If the developments had been contemporaneous an apportionment on a reasonable basis would have been appropriate.

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Subject references

Income tax, resource consent, depreciation, costs

Legislative references

Income Tax Act 1976 – s 124

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Income Tax Act 2007 – ss DA 1, DA 2, DB 19, DB 23, DB 46, DB 62, EA 2, subpart EE, ss EE 1–12, EE 16, EE 18, EE 19, EE 33, EE 37, EE 48, EE 50–60, EE 62, EE 67, FA 5, FA 9, YA 1, sch 13, sch 14, sch 19

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LEGISLATION AND DETERMINATIONS

This section of the *TIB* covers items such as recent tax legislation and depreciation determinations, livestock values and changes in FBT and GST interest rates.

Foreign currency amounts – conversion to New Zealand dollars (for the six months ending 30 September 2018)

This article provides the exchange rates acceptable to Inland Revenue for converting foreign currency amounts to New Zealand dollars under the controlled foreign company ("CFC") and foreign investment fund ("FIF") rules for the six months ending 30 September 2018.

The Income Tax Act 2007 ("2007 Act") requires foreign currency amounts to be converted into New Zealand dollars applying one of the following methods:

- actual rate for the day for each transaction (including close of trading spot exchange rate on the day), or
- rolling 12-month average rate for a 12-month accounting period or income year (see the table **Currency rates 6 months ending 30 September 2018 – rolling 12-month average**), or
- mid-month actual rate as the basis of the rolling average for accounting periods or income years greater or lesser than 12 months (see the table **Currency rates 6 months ending 30 September 2018 – mid-month actual**).

Legislation enacted in September 2010 with effect from 1 April 2008 permits the Commissioner to set currency rates and approve methods of calculating exchange rates. The Commissioner can set rates for general use by taxpayers or for specific taxpayers. The Commissioner's ability to set rates and approve methods applies in circumstances where the 2007 Act does not contain a specific currency conversion rule (sections YF 1(5) and (6)), or in circumstances where the 2007 Act provides a rate or method for currency conversion (section YF 2).

Inland Revenue uses wholesale rates from Bloomberg for rolling 12-month average, mid-month actual and end of month. These rates are provided in three tables.

You must apply the chosen conversion method to all interests for which you use the FIF or CFC calculation method in that and each later income year.

To convert foreign currency amounts to New Zealand dollars for any country listed, divide the foreign currency amount by the exchange rate shown. Round the exchange rate calculations to four decimal places wherever possible.

If you need an exchange rate for a country or a day not listed in the tables, please contact one of New Zealand's major trading banks.

Note: All section references relate to the 2007 Act.

Actual rate for the day for each transaction

The actual rate for the day for a transaction can be used in the following circumstances:

- where the 2007 Act does not provide a specific currency conversion rule, then foreign currency amounts can be converted by applying the close of trading spot exchange rate on the date the transaction is required to be measured or calculated (section YF 1(2))
- where a person chooses to use the actual rate for the day of the transaction when calculating their FIF income or loss by applying the comparative value method, fair dividend rate method, deemed rate of return method or the cost method (section EX 57(2)(a))
- where a person chooses to use the close of trading spot exchange rate to convert foreign income tax paid by a CFC (section LK 3(a)) or by a FIF where the attributable FIF income method is used (sections EX 50(8)–(9) and LK 3(a)).

Unless the actual rate is the rate for the 15th or the last day of the month, these rates are not supplied by Inland Revenue.

The table **Currency rates 6 months ending 30 September 2018 – month end** provides exchange rates for the last day of the month. These are provided for convenience to assist taxpayers who may need exchange rates on those days.

Currency rates 6 months ending 30 September 2018 – rolling 12-month average table

This table is the average of the mid-month exchange rate for that month and the previous 11 months, ie, the 12-month average. This table should be used where the accounting period or income year encompasses 12 complete months.

This table can be used to convert foreign currency amounts to New Zealand dollars for:

- FIF income or loss calculated under the comparative value method, the fair dividend rate method, the deemed rate of return method or cost method (section EX 57(2)(b)) for accounting periods of 12 months
- FIF income or loss calculated under the attributable FIF income method (sections EX 21(4)(b) and EX 50(3)(a)) for accounting periods of 12 months
- attributed CFC income or loss calculated under the CFC rules (section EX 21(4)(b)) for accounting periods of 12 months
- calculating the New Zealand dollar amount of foreign income tax under the CFC rules (section LK 3(b)) or under the FIF rules where the attributable FIF income method is used (sections EX 50(8)–(9) and LK 3(b)) for accounting periods of 12 months.

Currency rates 6 months ending 30 September 2018 – mid-month actual table

This table sets out the exchange rate on the 15th day of the month, or if no exchange rates were quoted on that day, on the preceding working day on which they were quoted. This table can be used as the basis of the rolling average where the accounting period or income year is less than or greater than 12 months (see Example 4). You can also use the rates from this table as the actual rate for any transactions arising on the 15th of the month.

This table can be used as the basis of the rolling average for calculating:

- FIF income or loss under the comparative value method, the fair dividend rate method, the deemed rate of return method or cost method (section EX 57(2)(b)) for accounting periods or income years of less than or greater than 12 months
- FIF income or loss calculated under the attributable FIF income method (sections EX 21(4)(b) and EX 50(3)(a)) for accounting periods of less than or greater than 12 months
- attributed CFC income or loss calculated under the CFC rules (section EX 21(4)(b)) for accounting periods of less than or greater than 12 months
- the New Zealand dollar amount of foreign income tax under the CFC rules (section LK 3(b)) or under the FIF rules where the attributable FIF income method is used (sections EX 50(8)–(9) and LK 3(b)) for accounting periods of less than or greater than 12 months.

Example 1

A taxpayer with a 30 September balance date purchases shares in a Philippine company (which is a FIF but does produce a guaranteed yield) on 7 September 2018. Its opening market value on 1 October 2018 or its closing market value on 30 September 2018 is PHP 350,000. Using the comparative value method and applying the actual rate for the day (section EX 57(2)(a)), the opening market value is converted as follows:

PHP 350,000 ÷ 35.7208 = $9,798.21

(In this example, the rate selected is the month-end rate for September 2018 for PHP. Refer to the table "**Currency rates 6 months ending 30 September 2018 – month end**".)

Example 2

A CFC resident in Hong Kong has an accounting period ending on 30 June 2018. Attributed CFC income for the period 1 July 2017 to 30 June 2018 is 200,000 Hong Kong dollars (HKD), which converts to:

HKD 200,000 ÷ 5.6126 = $35,634.11

(In this example, the rate selected is the rolling 12-month average rate for June 2018 for HKD. Refer to the table "**Currency rates 6 months ending 30 September 2018 – rolling 12-month average**".)

Example 3

A resident individual with a 30 September 2018 accounting period acquired a FIF interest in a Japanese company on 1 October 2017 for 10,500,000 yen. The interest is sold in September 2018 for 10,000,000 yen. Using the comparative value method and applying section EX 57(2)(b), these amounts are converted as:

JPY 10,500,000 ÷ 77.2760 = $135,876.60

JPY 10,000,000 ÷ 77.2760 = $129,406.28

(In this example, the rolling 12-month rate for September 2018 for JPY has been applied to both calculations. Refer to the table "**Currency rates 6 months ending 30 September 2018 – rolling 12-month average**".)

Example 4

A CFC resident in Singapore was formed on 20 April 2018 and has a balance date of 30 September 2018. During the period 1 May 2018 to 30 September 2018, attributed CFC income of 500,000 Singaporean dollars was derived. For the conversion to New Zealand dollars the taxpayer chooses the method set out in section EX 21(4)(b).

1. Calculating the average monthly exchange rate for the complete months May–September 2018:

   0.9227 + 0.9385 + 0.9221 + 0.9061 + 0.9001 = 4.58907

   4.58907 ÷ 5 = 0.917814

2. Round exchange rate to four decimal places: 0.9178

3. Conversion to New Zealand currency:

   SGD 500,000 ÷ 0.9178 = $544,781.00

(In this example, the rates are from the table "**Currency rates 6 months ending 30 September 2018 – mid-month actual**", from May to September 2018 inclusive for SGD.)

Currency rates 6 months ending 30 September 2018 – rolling 12-month average

Currency	Code	15/04/18	15/05/18	15/06/18	15/07/18	15/08/18	15/09/18
Australia Dollar	AUD	0.9262	0.9254	0.9239	0.9216	0.9201	0.9204
Bahrain Dinar	BHD	0.2713	0.2713	0.2705	0.2688	0.2667	0.2643
Britain Pound	GBP	0.5366	0.5345	0.5309	0.5268	0.5230	0.5200
Canada Dollar	CAD	0.9182	0.9136	0.9103	0.9069	0.9019	0.8989
China Yuan	CNY	4.7262	4.6958	4.6595	4.6229	4.5997	4.5767
Denmark Kroner	DKK	4.5289	4.5001	4.4707	4.4333	4.4108	4.3823
Euporean Community Euro	EUR	0.6086	0.6046	0.6005	0.5954	0.5922	0.5883
Fiji Dollar	FJD	1.4725	1.4704	1.4671	1.4604	1.4543	1.4478
French Polynesia Franc	XPF	72.5984	72.1281	71.6418	71.0321	70.6594	70.1909
Hong Kong Dollar	HKD	5.6246	5.6269	5.6126	5.5772	5.5350	5.4878
India Rupee	INR	46.3764	46.6052	46.6717	46.5907	46.5368	46.5918
Indonesia Rupiah	IDR	9,697.4133	9,742.4808	9,759.3800	9,752.9825	9,737.0467	9,748.0250
Japan Yen	JPY	79.5268	79.3112	79.0557	78.4923	77.8769	77.2760
Korea Won	KOR	793.8149	791.4535	787.3266	781.8825	775.3853	767.7109
Kuwait Dinar	KWD	0.2171	0.2169	0.2161	0.2147	0.2131	0.2113
Malaysia Ringit	MYR	2.9713	2.9507	2.9243	2.8899	2.8528	2.8262
Norway Krone	NOK	5.7959	5.7699	5.7298	5.6862	5.6687	5.6419
Pakistan Rupee	PKR	77.6355	78.2541	78.8854	79.2560	79.6151	79.9799
Phillipines Peso	PHP	36.7417	36.9119	37.0028	36.9240	36.7239	36.5817
PNG Kina	PGK	2.3090	2.3132	2.3107	2.3021	2.2919	2.2789
Singapore Dollar	SGD	0.9698	0.9666	0.9616	0.9545	0.9476	0.9408
Solomon Islands Dollar*	SBD	0.0927	0.0928	0.0927	0.0920	0.0911	0.0903
South Africa Rand	ZAR	9.2394	9.2021	9.2061	9.1572	9.1515	9.1650
Sri Lanka Rupee	LKR	110.6913	110.9774	111.0791	110.6764	110.1891	109.8904
Sweden Krona	SEK	5.9676	5.9579	5.9401	5.9322	5.9492	5.9586
Swiss Franc	CHF	0.6966	0.6967	0.6959	0.6933	0.6890	0.6835
Taiwan Dollar	TAI	21.4724	21.4599	21.3853	21.2558	21.1178	20.9667
Thailand Baht	THB	23.5463	23.4022	23.2523	23.0638	22.8797	22.6497
Tonga Pa'anga*	TOP	1.5683	1.5664	1.5627	1.5549	1.5513	1.5456
United States Dollar	USD	0.7198	0.7196	0.7175	0.7125	0.7069	0.7007
Vanuatu Vatu	VUV	76.8478	76.5251	76.1926	75.7063	75.4235	75.1449
West Samoan Tala*	WST	1.7977	1.7963	1.7923	1.7832	1.7811	1.7735

Notes to table:

All currencies are expressed in NZD terms, ie, 1NZD per unit(s) of foreign currency.

The currencies marked with an asterisk * are not published on Bloomberg in NZD terms. However, these currencies are expressed in USD terms and therefore the equivalent NZD terms have been generated as a function of the foreign currency USD cross-rate converted to NZD terms at the NZDUSD rate provided.

The rates provided represent the Bloomberg generic rate (BGN) based on the last price (mid rate) at which the currency was traded at the close of the New York trading day. Where the date specified was not a trading day, then the rate reflects the last price on the preceding business day.

Source: Bloomberg CMPN BGN

Currency rates 6 months ending 30 September 2018 – mid-month actual

Currency	Code	15/04/18	15/05/18	15/06/18	15/07/18	15/08/18	15/09/18
Australia Dollar	AUD	0.9473	0.9184	0.9332	0.9110	0.9071	0.9149
Bahrain Dinar	BHD	0.2772	0.2588	0.2623	0.2564	0.2476	0.2467
Britain Pound	GBP	0.5165	0.5081	0.5227	0.5113	0.5171	0.5007
Canada Dollar	CAD	0.9271	0.8836	0.9168	0.8883	0.8628	0.8541
China Yuan	CNY	4.6165	4.3710	4.4685	4.5266	4.5534	4.4960
Denmark Kroner	DKK	4.4404	4.3185	4.4573	4.3151	4.3149	4.2015
Eupopean Community Euro	EUR	0.5966	0.5797	0.5979	0.5789	0.5788	0.5632
Fiji Dollar	FJD	1.4925	1.4280	1.4474	1.4243	1.4021	1.3996
French Polynesia Franc	XPF	71.1246	69.1395	71.3323	69.1062	69.0793	67.2136
Hong Kong Dollar	HKD	5.7734	5.3871	5.4489	5.3088	5.1546	5.1360
India Rupee	INR	48.1482	46.9939	47.2908	46.1069	46.0272	47.2776
Indonesia Rupiah	IDR	10163.4800	9703.3200	9806.8400	9682.5100	9548.0400	9758.1500
Japan Yen	JPY	79.0270	75.7200	76.8980	75.9130	72.6950	73.6690
Korea Won	KOR	788.2948	741.6451	765.7613	764.6012	744.3127	734.3763
Kuwait Dinar	KWD	0.2206	0.2071	0.2101	0.2051	0.1993	0.1981
Malaysia Ringit	MYR	2.8668	2.7354	2.7665	2.7280	2.6874	2.7273
Norway Krone	NOK	5.7199	5.5734	5.6526	5.4893	5.5510	5.4033
Pakistan Rupee	PKR	84.7458	79.3651	83.3333	81.9672	80.6452	81.3008
Phillipines Peso	PHP	38.4202	36.2604	37.0358	36.0631	35.0731	35.5542
PNG Kina	PGK	2.3917	2.2395	2.2648	2.2335	2.1748	2.1746
Singapore Dollar	SGD	0.9649	0.9227	0.9385	0.9221	0.9061	0.9000
Solomon Islands Dollar*	SBD	0.0947	0.0892	0.0907	0.0864	0.0818	0.0838
South Africa Rand	ZAR	8.8851	8.6248	9.3322	8.9766	9.5654	9.7728
Sri Lanka Rupee	LKR	114.9425	108.6957	111.1111	107.5269	105.2632	107.5269
Sweden Krona	SEK	6.2335	5.9592	6.0929	6.0104	6.0441	5.9228
Swiss Franc	CHF	0.7080	0.6870	0.6931	0.6763	0.6523	0.6343
Taiwan Dollar	TAI	21.5781	20.5297	20.9272	20.6958	20.2707	20.1412
Thailand Baht	THB	22.9285	22.0474	22.6786	22.5377	21.8855	21.3868
Tonga Pa'anga*	TOP	1.5914	1.5273	1.5365	1.5135	1.4912	1.4954
United States Dollar	USD	0.7365	0.6862	0.6949	0.6753	0.6565	0.6549
Vanuatu Vatu	VUV	76.9231	72.4638	73.5294	73.5294	73.5294	72.9927
West Samoan Tala*	WST	1.8703	1.7489	1.7580	1.7307	1.7150	1.7230

Notes to table:

All currencies are expressed in NZD terms, ie, 1NZD per unit(s) of foreign currency.

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The rates provided represent the Bloomberg generic rate (BGN) based on the last price (mid rate) at which the currency was traded at the close of the New York trading day. Where the date specified was not a trading day, then the rate reflects the last price on the preceding business day.

Source: Bloomberg CMPN BGN

Currency rates 6 months ending 30 September 2018 – month end

Currency	Code	30/04/18	31/05/18	30/06/18	31/07/18	31/08/18	30/09/18
Australia Dollar	AUD	0.9350	0.9251	0.9146	0.9178	0.9206	0.9166
Bahrain Dinar	BHD	0.2672	0.2644	0.2563	0.2577	0.2498	0.2496
Britain Pound	GBP	0.5143	0.5266	0.5131	0.5196	0.5109	0.5084
Canada Dollar	CAD	0.9098	0.9070	0.8887	0.8869	0.8638	0.8549
China Yuan	CNY	4.4900	4.4877	4.4870	4.6439	4.5216	4.5496
Denmark Kroner	DKK	4.3538	4.4564	4.3200	4.3463	4.2544	4.2548
Eupopean Community Euro	EUR	0.5843	0.5987	0.5795	0.5832	0.5706	0.5706
Fiji Dollar	FJD	1.4635	1.4516	1.4294	1.4329	1.4071	1.4138
French Polynesia Franc	XPF	69.7227	71.4536	69.2043	69.6070	68.0651	68.0470
Hong Kong Dollar	HKD	5.5607	5.4906	5.3171	5.3520	5.1965	5.1839
India Rupee	INR	47.0380	47.2825	46.2857	46.7442	47.0960	47.9300
Indonesia Rupiah	IDR	9790.53	9723.72	9698.51	9824.28	9780.68	9849.96
Japan Yen	JPY	77.3280	76.1710	74.9500	76.2460	73.5350	75.2660
Korea Won	KOR	756.9887	756.4695	755.6001	759.1365	738.3689	734.8708
Kuwait Dinar	KWD	0.2133	0.2115	0.2052	0.2065	0.2004	0.2006
Malaysia Ringit	MYR	2.7617	2.7843	2.7328	2.7707	2.7320	2.7342
Norway Krone	NOK	5.6425	5.7266	5.5202	5.5636	5.5583	5.3974
Pakistan Rupee	PKR	81.9672	80.6452	81.9672	84.7458	81.3008	81.9672
Phillipines Peso	PHP	36.5833	36.7630	36.1264	36.1946	35.6105	35.7208
PNG Kina	PGK	2.3050	2.2847	2.2288	2.2508	2.1994	2.2147
Singapore Dollar	SGD	0.9381	0.9365	0.9222	0.9282	0.9084	0.9054
Solomon Islands Dollar*	SBD	5.5257	5.4981	5.2926	5.3317	5.1785	5.1761
South Africa Rand	ZAR	8.7463	8.8929	9.2971	9.0526	9.7221	9.3690
Sri Lanka Rupee	LKR	112.3596	111.1111	107.5269	108.6957	106.3830	112.3596
Sweden Krona	SEK	6.1434	6.1701	6.0586	5.9979	6.0504	5.8883
Swiss Franc	CHF	0.7000	0.6900	0.6705	0.6752	0.6412	0.6503
Taiwan Dollar	TAI	20.9801	20.9910	20.6556	20.8474	20.3145	20.1637
Thailand Baht	THB	22.3438	22.4414	22.3782	22.6401	21.6926	21.4024
Tonga Pa'anga*	TOP	1.5598	1.5586	1.5149	1.5319	1.4994	1.4882
United States Dollar	USD	0.7086	0.7001	0.6768	0.6818	0.6622	0.6619
Vanuatu Vatu	VUV	75.1880	74.0741	74.0741	74.6269	72.9927	74.6269
West Samoan Tala*	WST	1.7900	1.7771	1.7355	1.7470	1.7236	1.7160

Notes to table:

All currencies are expressed in NZD terms, ie, 1NZD per unit(s) of foreign currency.

The currencies marked with an asterisk * are not published on Bloomberg in NZD terms. However, these currencies are expressed in USD terms and therefore the equivalent NZD terms have been generated as a function of the foreign currency USD cross-rate converted to NZD terms at the NZDUSD rate provided.

The rates provided represent the Bloomberg generic rate (BGN) based on the last price (mid rate) at which the currency was traded at the close of the New York trading day. Where the date specified was not a trading day, then the rate reflects the last price on the preceding business day.

Source: Bloomberg CMPN BGN

LEGAL DECISIONS – CASE NOTES

This section of the *TIB* sets out brief notes of recent tax decisions made by the Taxation Review Authority, the High Court, Court of Appeal, and the Supreme Court.

We've given full references to each case, including the citation details where it has already been reported. Details of the relevant Act and section will help you to quickly identify the legislation at issue. Short case summaries and keywords deliver the bare essentials for busy readers. The notes also outline the principal facts and grounds for the decision.

These case reviews do not set out Inland Revenue policy, nor do they represent our attitude to the decision. These are purely brief factual reviews of decisions for the general interest of our readers.

Horse racing club entitled to GST input deduction on stakes paid to GST-registered riders and trainers

Case	*Canterbury Jockey Club v Commissioner of Inland Revenue* [2018] NZHC 2569
Decision date	1 October 2018
Act(s)	Goods and Services Tax Act 1985
Keywords	Stake money, horse trainers, riders, jockeys, horse racing, racing clubs

Summary

This case involved the issue of entitlement to input tax deductions under the Goods and Services Tax Act 1985 ("the GST Act") for stakes payments paid to GST registered trainers and jockeys in the horse racing industry.

Canterbury Jockey Club Inc ("CJC") had claimed GST input deductions on stakes payments paid to GST registered trainers and riders in horse races CJC conducted. CJC argued trainers and riders provide services to it on race days for consideration in the form of stakes payments, and therefore it was entitled to GST input deductions for stakes payments made to trainers and riders who win.

The Commissioner of Inland Revenue ("the Commissioner") argued that trainers and riders did not supply services to CJC and the stakes payments made by CJC were not consideration for any services. Trainers and riders instead supply services only to the horse owners.

Impact

The case establishes the GST position, with respect of stakes paid to GST-registered riders and trainers, for similarly situated clubs in the horse racing industry.

Facts

CJC is an incorporated society, and a "racing club" under s 5 of the Racing Act 2013. It is registered for GST with a taxable activity of horse racing. Racing clubs such as CJC are responsible for organising, managing and promoting race meetings where horses compete in races for prize money which is known as stakes or stakes money. The New Zealand Racing Board (NZRB) oversees the racing industry and conducts betting on racing for the harness, greyhound and thoroughbred horse racing codes. Betting may only occur at race meeting conducted by registered racing clubs. Profits from betting by NZRB are distributed to the three racing codes.

New Zealand Thoroughbred Racing ("NZTR") is the governing body overseeing the thoroughbred racing code. It distributes NZTR's share of NZRB's profits among its registered racing clubs, including CJC.

NZTR establishes, enforces and amends the Rules of Racing 2013 ("the Rules") which govern the various relationships and interactions between, among others, registered clubs, horse owners, trainers and riders. The Racing Act gives NZTR the sole authority to make and administer the Rules and to provide for "prize money and other stakes". NZTR regulates what stakes are paid for, to whom, and in how many pools. From 1 June 2013, the Rules came into effect by which NZTR (on behalf of clubs) must pay to the owners, trainers and riders their share of their stake money. NZTR also collects, on behalf of clubs, entry fees payable when a horse is nominated and accepted for a race and distributes the stake money.

Stakes payments are paid to reward the connections of a horse that finishes in a stakebearing place. They also serve to attract owners and trainers to enter their horses into the club's races, thereby increasing the quality of horses and number of people engaging with race meetings.

Horse trainers usually receive a monthly fee from horse owners and are in the business of providing services of training horses. Riders are normally engaged by the trainer, but the owner may also be involved. The rider is paid a set fee to ride at races, regardless of the outcome of the race.

Clubs are not a party to either of these arrangements and most trainers and riders are GST registered. Trainers are described as "the agent for the owner" and it is rare for owners to nominate their horse for a race, instead it is the horse's trainer who normally does this.

The Rules prescribe that NZTR, on behalf of the clubs, shall pay stakes to trainers and riders directly. NZTR is required to deduct any amount of tax that it is legally obliged to deduct from the stakes and issue, on behalf of the club, any tax invoice required. Those that receive stake payments and who are GST registered, must pay GST on the stakes payments.

The clubs collect the GST on the stakes payments for payment to the IRD. Clubs file their own GST returns and make any required GST payments to IRD directly.

CJC filed its GST return for the period ending 30 September 2013 excluding a claim for input tax credits of $102,428.82 for stakes payments made to GST registered trainers and riders. CJC did so with the intention of proposing an adjustment, which it did on 18 December 2013, increasing CJC's total purchases and expenses (including GST) by $102,428.82 and in turn increasing the GST refund owed to CJC by $13,360.28 for the period.

The Commissioner rejected the proposed adjustment on 13 February 2014 and issued a Notice of Response ("NOR") the next day. CJC then challenged the NOR by way of this test case, as a representative club for the racing industry.

Decision

Do trainers and riders supply services to CJC?

Regarding the meaning of "supply", the Court found there must be a transfer of something to someone else as well as a nexus or connection between the payment and the supply of services, with reciprocity in the legal relationship between both parties. The Court accepted that there was a legal arrangement between CJC and rider/trainer participants that was governed by the Rules which imposed enforceable and reciprocal obligations, and such obligations can give rise to a supply for GST purposes. The Court made no finding as to whether the Rules created a contractual relationship between CJC and trainers/riders as in any case, a contractual relationship was not critical to determining the issues here.

Regarding the services provided by riders and trainers on race day, the Court accepted that trainers and riders do not contract with CJC to provide services and that they provide training and riding services to the owners, for which they are paid. However, a contract is not necessary for there to be a 'supply of services' (as held in the Court of Appeal decision in *Turakina Maori Girls College Board of Trustees v Commissioner of Inland Revenue* (1993) 15 NZTC 10,032 (CA)). The Court found that trainers and riders do provide services to CJC on race day by entering the race, participating in accordance with the Rules, and providing a stake winning performance. The Court came to that conclusion due to three factors;

(1) CJC works in the promotion of its horse races. Its profit is largely from betting, which itself is advanced by having a more competitive pool of racehorses;

(2) The Rules since 2013 require NZTR to pay stake money, plus GST, on behalf of CJC to trainers and riders, and to render tax invoices for CJC to pay GST. The Court held it would be "problematic" for the Commissioner to deny input tax deductions when a club (through NZTR) must ensure the GST component is paid for the trainers' and riders' services on race day (at [83]); and

(3) Without the input tax deductions being claimed by CJC, the GST payment on stake money is not neutral (GST was intended to be broad-based and neutral).

Regarding the Commissioner's argument that the riders and trainers provided a benefit, for which CJC paid stakes money, rather than services, the Court found that participation by trainers and riders on race day is a supply of services from which CJC derives a benefit. That benefit does not affect the fact that there is a supply for services.

Are stakes payments to trainers and riders consideration for the services provided?

In considering whether there was a sufficiently strong connection or nexus between the payment of stakes and the supply of goods to constitute consideration, the Court found the payment must induce the trainers/riders to provide their services on race day and that the payment of stakes did, in fact, induce the trainers/riders to perform. Thus, the payments were consideration for their services. Consideration was given here regardless of whether the parties were in a contractual relationship or not.

The Commissioner submitted that the stakes payments were actually "prizes" given as a reward to a winner, rather than "fees" contingent on success. The Court rejected that argument and found that stakes payments are consideration for the services of trainers and riders and are treated as such under both the Rules and in practice, because in the hands of GST registered participants, the stakes payments are GST liable.

Overall the Court found that CJC was entitled to GST input tax deductions for stakes payments made to GST registered trainers and riders in horse races conducted by CJC.

Commissioner's application to strike out a judicial review application granted

Case	*Peter William Mawhinney v Commissioner of Inland Revenue and Taxation Review Authority* [2018] NZHC 2604
Decision date	5 October 2018
Act(s)	High Court Rules 2016, r 15.1(1) (strike out); Tax Administration Act 1994 Parts 4A (disputes procedure), 6 (assessments) and 8A (challenge procedure)
Keywords	Jurisdiction, strike-out, abuse of process, disputes process, challenge process

Summary

Mr Mawhinney ("the Applicant"), as trustee of the Sixty-Six Auckland Trust ("the Trust") applied for a judicial review of decisions by the Commissioner of Inland Revenue ("the Commissioner") and the Taxation Review Authority ("the TRA").

The Trust challenged:

(1) The Commissioner's decision not to complete the disputes process pursuant to the Trust's notice of proposed adjustment ("NOPA");

(2) The Commissioner's decision to invoke s 89C(eb) in respect of the 2008 reassessment; and

(3) The TRA's decision to strike out its challenge in relation to the 2008 reassessment.

The Commissioner applied to strike out the application for judicial review on the basis the Court had no jurisdiction to hear most of the complaint, and even if there was jurisdiction, the statement of claim did not disclose an arguable cause of action and was an abuse of process.

The Court found for the Commissioner and struck out the proceeding for lack of jurisdiction. The Court also noted that if it was wrong in that conclusion, the statement of claim disclosed no arguable cause of action and struck it out on that basis.

Impact

The Court confirmed that the disputes and challenge processes cannot be engaged concurrently. If a taxpayer utilises its challenge rights, its right to continue with a dispute comes to an end. If a taxpayer discontinues its challenge before the Court, it cannot go back and "have a second bite of the cherry" by attempting to restart or continue the disputes process with the Commissioner.

Facts

This case revolves around GST returns filed by the Trust. For the period ended 31 July 2008, the Trust claimed a GST refund of $144,706.72 on the basis it had purchased a property for approximately $1.3 million. Then, for the period ended 31 March 2009, the Trust returned GST output tax of $144,444.44 on the basis it had sold the property for approximately $1.3 million.

The Commissioner formed the view the Trust was not carrying on any taxable activity. Accordingly, on 30 March 2011 the Commissioner reassessed the July 2008 refund to nil ("the 2008 Reassessment") and the March 2009 refund to nil ("the 2009 Reassessment"). The Commissioner did not first issue a NOPA pursuant to s 89C(eb) of the Tax Administration Act 1994 ("the TAA 1994").

On 4 May 2011, the Commissioner cancelled the Trust's GST registration with effect from the taxable period ending 31 September 2010. This too reflected the Commissioner's view the Trust was not carrying on any taxable activity.

On 29 July 2011 the Trust issued a NOPA in relation to the 2008 reassessment initiating the disputes procedure under Part 4A of the TAA. Instead of progressing the disputes procedure, on 3 August 2011 the Trust issued challenge proceedings in the TRA in relation to the 2008 reassessment.

On 26 September 2011 the Commissioner rejected the trust's NOPA in full by issuing a notice of response ("NOR").

On 24 November 2011 the Commissioner wrote to the Trust requesting clarification of whether the Trust wanted to go through the disputes procedure or the challenge procedure. The Trust advised the Commissioner it wished to pursue the challenge in the TRA and requested for the disputes procedures to "be put in abeyance in the meantime".

On 20 January 2012, the Trust registered for GST again effective from 20 January 2012.

On 26 June 2013 the Commissioner applied to strike out the challenge proceedings. Before the strike out application was heard, the Trust discontinued the challenge proceedings on 30 September 2013. On the same day the Applicant wrote to the Commissioner on behalf of the Trust asking to progress the dispute.

On 18 October 2013 the Commissioner declined this request on the basis that by discontinuing the TRA challenge proceedings the Trust had accepted the Commissioner's assessment.

The Commissioner heard nothing from the Applicant for almost two years until on 3 August 2015 the Applicant wrote to the Commissioner, again on behalf of the Trust, advising that it had been four years since the Trust's NOPA was issued and requested the excess GST be refunded.

On 19 September 2016 the Commissioner advised the Applicant she did not consider there to be any live dispute or excess GST refund available.

In August 2017 the Trust filed a notice of claim in the TRA in relation to the 2008 reassessment and the cancellation of the Trust's GST registration with effect from 30 September 2015.

On 29 January 2018 the TRA struck out the application in relation to the 2008 reassessment pursuant to s 138H of the TAA on the basis it had not been commenced within the statutory response period, and therefore did not comply with the requirements of s 138B.

In February 2018 the Trust commenced judicial review proceedings.

Decision

Jurisdiction

In assessing whether there was jurisdiction the Court applied the test from the Supreme Court in *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153 where it held that because of s 109 of the TAA judicial review will only be available in limited circumstances where:

(1) It is not practically possible for a taxpayer to challenge an assessment under Part 8A. This will be rare.

(2) If the issue concerns some suggested flaw in the statutory process that needs to be addressed outside the statutory regime.

The Court found this proceeding did not fall within either of the two narrow categories.

First, the Court rejected the Trust's argument that the Commissioner had misinterpreted s 89C(eb) of the TAA, this could not be challenged (because the decision to exercise s 89C(3b) was not an assessment (TAA s 3) or a disputable decision (TAA s138E(1)(E)(iv))) meaning judicial review was the only available remedy to the Trust.

While the Commissioner's decision to issue the NOPA under s 89C(eb) cannot be challenged, the resulting reassessment can, and was, challenged in 2011. When the Trust discontinued its challenge in 2013, its disputes and challenge rights were exhausted. The Trust "does not get another shot" at exercising its disputes and challenge rights once these rights were exhausted.

Second, there was no flaw in the statutory process which needed to be addressed outside the statutory regime. The Trust sought relief that was within the statutory procedures.

Arguable causes of action

The Court considered the Trust's statement of claim did not disclose any arguable causes of action. The Court rejected the Trust's grounds for judicial review and held overall that the Commissioner did not err in holding that the disputes procedures in relation to the 2008 reassessment concluded when the challenge rights were properly exercised.

The Trust received incorrect advice that the disputes and challenge processes were to be initiated at the same time. The Trust was not able by law to commence challenge proceedings until the Commissioner issued its NOR on 26 September 2011.

The Court did not accept that the disputes process was intended to only be suspended when the Trust asked the disputes process to "be put in abeyance" following its application to utilise the challenge procedures. The Court considered that the legislation was not designed to allow the two processes to run in tandem meaning the Trust could not swap between the disputes and challenge processes at will.

The Court did not accept that agreement in writing between the Trust and the Commissioner was required for the disputes process to cease. Section 89N(1)(c)(viii) of the TAA clearly permits the submission of a dispute to the court or TRA without completion of the disputes process. That provision is, however, is in addition to the power of the taxpayer to opt out of the disputes process under the former s 138B(3). A taxpayer using the former s 138B(3) did not require the agreement of the Commissioner to do so and the Trust did not in fact seek agreement before initiating the challenge process.

The Court rejected the Trust's arguments as to why it discontinued the challenge process as immaterial to the issues at hand.

The Court rejected the Trust's arguments that the Commissioner wrongly omitted to complete the disputes process. The Court confirmed that by discontinuing the challenge process in the TRA, the dispute process was effectively at an end. The Court considered that despite there being no specific provision providing that a notice of discontinuance automatically ends the disputes process, there was no other logical and reasonable outcome based on a purposive interpretation of the legislation. In the Court's words "the Trust was not able to have a second bite of the cherry".

Parents' payments to private school were not unconditional gifts, but were consideration for the supply of education services and subject to GST

Case	*XXX* [2018] NZTRA 08
Decision date	18 October 2018
Act(s)	Goods and Services Tax Act 1985 s 2
Keywords	unconditional gifts, consideration, 'in respect of, in response to or for the inducement of'

Summary

The disputant challenged the assessments for goods and services tax ("GST") made by the Commissioner of Inland Revenue ("the Commissioner") for the seven six-monthly GST periods ("the relevant tax periods").

The disputant argued it was not liable to pay output GST on payments made by parents at one of their schools, as those payments were charitable donations and therefore were unconditional gifts. However, the Commissioner argued those payments were consideration for the provision of education services by the disputant and therefore liable for output GST. The Taxation Review Authority ("the Authority") found in favour of the Commissioner.

Impact

The decision will be applicable to a wide range of pre-schools and private schools which may have been treating parent payments as donations when the payments are consideration for educational services.

Facts

The disputant was established under a Deed of Trust and was registered with Charities Services as a charity whose sector of operation was recorded as "education, training and research" with the charitable purpose of advancement of education. The disputant operates a primary school ("the School").

The School was treated as a private school under the Education Act 1989 and thus received minimal state funding. The majority of funding for the School came from payments made by parents.

It was accepted that the disputant was registered for GST purposes and that it supplied education services in the course or furtherance of a taxable activity.

Decision

Were the payments consideration under the GST Act?

The Authority found that to constitute "consideration", it was not necessary that the supply be to the person providing payment, however there must be a sufficient connection (linkage or nexus) between the supply and the payment. This is highlighted by the reciprocity found in the expression "in respect of, in response to, or for the inducement of" in s 2.

The Authority found that the s 2 definition of "consideration" clearly includes voluntary payments. There is no requirement for there to be "legally enforceable" reciprocal obligations as to hold such would be inconsistent with the definition.

Details of the School's funding model as contained on its website, information sheets, and contribution forms sent to current and prospective students' parents conveyed a clear expectation that parents would pay the amounts requested, or what they were able to afford, and the payments would be used to pay the School's operating costs including salaries.

In 2013, a scholarship fund was introduced which allowed parents who were unable to commit to making payment of the required amount ($5,000), to meet the remaining amount. However, the Authority found that the concept had been introduced as another way to obtain contributions which may have been less embarrassing for those who did not pay the amount required.

Only six children (two from one family) were identified as having attended the school where either no parent contributions were paid or were not paid for substantial periods of time in the years from 2003 to 2015. In addition, financial contributions from parents ceased or substantially reduced when their children left the School.

Overall the Authority held there was a supply of education services by the disputant to the parents' children and a payment made by parents to the disputant in connection with the supply of those services. This connection, the Authority said, was sufficient to satisfy the definition of "consideration" in s 2.

Were the payments unconditional gifts made to the disputant?

Consideration does not include any payment made as an unconditional gift, as defined in the GST Act. The Authority considered the decision of Judge Barber in *Case U37* (2009) 19 NZTC 9,353 involving a religious organisation which had received payment from the lessor of premises occupied by the organisation. Barber J found that for there to be an unconditional gift, payment (to a non-profit body) must be voluntary and no direct valuable benefit may arise in the form of goods and services to the payer, or if such benefit does arise, it must not be *conditional or dependant* on that payment (at [42]). The Authority considered that Judge Barber had contemplated that the benefit must not be conditional (contingent) or dependent (reliant) on the voluntary payment in order to be an unconditional gift.

In this case, the Authority found that owing to the School's communications with parents, those parents were left in no doubt as to the cost of running the school and the need for contributions to be made by them at a level they could afford, in order to meet operating costs.

Whilst children were not excluded from attending the School if their parents were unable to make the contribution (meaning attendance was not "conditional" on making a contribution), the Authority found that the supply of education services by the disputant was "dependant" on the parents' contributions. If such contributions were not made, the School would not have been able to operate. Furthermore, the Authority found that parents received a direct and valuable benefit because of their contributions being the provision of education for their children.

Accordingly, the Authority found that the contributions made by parents were not unconditional gifts for the purposes of the GST Act.

Accountant loses appeal in High Court for expenditure on rental properties and treatment of trust income and expenses

Case	*Wong v Commissioner of Inland Revenue* [2018] NZHC 2729
Decision date	19 October 2018
Act(s)	Tax Administration Act 1994 and Income Tax Act 2007
Keywords	Onus of proof, personal and business expenses, tax shortfall

Summary

This decision concerns the appellant taxpayer's (Mr Wong) appeal against the Taxation Review Authority's ("the Authority") decision upholding the Commissioner of Inland Revenue's ("the Commissioner") assessments in the 2013 and 2014 income years ("years in dispute") (*TRA Case 09/16* [2017] NZTRA 04). The Commissioner disallowed interest and other expenditure on funds borrowed to purchase properties for commercial rental having the effect of increasing Mr Wong's taxable income. The High Court was not satisfied that Mr Wong had discharged his onus of showing how and by how much the Commissioner's assessments were wrong ultimately finding the Authority's decision correct in all respects and disallowing the appeal.

Impact

This decision confirms, as per *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289, that the onus of proof rests on the taxpayer to show that the Commissioner's assessments are wrong and by how much they are wrong (at [171]). The ability to accrue, carry forward and apply tax losses falls within the broad definition of a "tax shortfall" pursuant to ss 3 and 141 of the TAA, being a tax benefit, credit or advantage of any type or description whatever benefiting the taxpayer or another person.

Facts

Mr Wong is a chartered accountant and operates a consultancy business from his residential address. Mr Wong's rental and consultancy income went into his various revolving credit accounts. Business and personal expenditure were paid by the disputant from personal credits cards and from funds in the revolving credit accounts.

Three rental properties were identified by the Commissioner during her investigation into Mr Wong's tax affairs. The first property was purchased by Mr Wong in 2002 ("Upland Road") for $555,000 and in the name of the Madeline Francesca Family Trust ("the Trust"). Mr Wong and his brother are trustees with Mr Wong and his daughter being beneficiaries. In September 2003, Mr Wong and his late partner purchased a rental property ("Ranfurly Road") for $685,000 and another in August 2004 ("Victoria Avenue") for $842,000. The total cost of the properties was $2,082,000. Funding for the properties was largely obtained by loan and credit facilities from ASB.

Mr Wong claimed interest on the borrowings for the Ranfurly Road property for only a small part of the 2013 income year. He also claimed interest in respect of the Victoria Avenue and Upland Road property for both tax years in dispute.

Decision

The High Court dismissed the appeal finding the Authority's decision was correct in all respects.

Interest deductions

The High Court held that upon sale of the Ranfurly Road property the debt relating to the acquisition of that property should be excluded. The Court also suggested that it would be necessary to exclude part of the debt attributable to Upland Road, given it was owned by the Trust, Mr Wong failing to establish sufficient nexus pursuant to ss DA 1 and DB 6 of the Income Tax Act 2007.

While the High Court agreed with Mr Wong's counsel that interest deductions on the Victoria Avenue property would have exceeded that allowed in the Commissioner's assessment, Mr Wong had failed to prove the underlying premise, that the entire sum of $842,000 remained outstanding, and the actual interest paid thereon. The High Court was not persuaded that the Authority erred in rejecting Mr Wong's claim that he was entitled to deductions for interest that he sought (*Wong v Commissioner of Inland Revenue* [2018] NZHC 2729 at [31]).

Upland Road

Mr Wong challenged the Authority's finding that he was not entitled to deductions in relation to Upland Road submitting that the Commissioner "can't have it both ways" i.e. that he should not be liable for the tax on the income from the property but at the same time be denied deductions for expenses. However, the High Court, in agreeing with the Authority, determined that Mr Wong was not entitled to deduct any expenses for insurance and rates for Upland Road given those expenses were incurred by the trustees of the Trust as owners of the property (at [46]-[48]).

Penalties

In the Authority, Mr Wong contended that no tax shortfall arose because once his accumulated losses were taken into account, he had no taxable income in either of the years in dispute. The question before the Authority was whether the tax position taken by the disputant, in not filing tax returns by the due date, "overstate[d] a *tax benefit, credit or advantage of any type or description whatever* by or benefitting…the disputant or another person. (Italics added)" (*TRA Case 09/16* [2017] NZTRA 04 at [66]).

On this point, the Authority concluded that the ability to accrue and carry forward tax losses thereby reducing the amount of tax payable on income earned in subsequent years is plainly a tax advantage to any taxpayer. The Authority was therefore satisfied that the disputant had taken a tax position that resulted in a tax shortfall in each of the years in dispute.

The High Court agreed that the Authority's decision was correct for the reasons it gave (at [62]). Furthermore, the High Court agreed with the Commissioner's submission that s 141 of the Tax Administration Act 1994 (TAA) made it clear that a tax shortfall may still arise if a taxpayer has no tax to pay (at [64]).

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