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TAX INFORMATION
Bulletin

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Inland Revenue
Te Tari Taake

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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 **taxtechnical.ird.govt.nz** (search keywords: public consultation).

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

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

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

Your opportunity to comment

Ref	Draft type	Title	Comment deadline
PUB00376	Interpretation statement	Loss carry-forward – continuity of business activities	1 September 2022
PUB00398	Interpretation statement	Company losses – ownership continuity, sharing and measurement	23 September 2022
PUB00341	Questions we've been asked	Payments by parents to private schools	26 September 2022

IN SUMMARY

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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.

Order in Council - Tax Administration (July Adverse Weather Event) Order 2022.

Remission of use-of-money interest for the July adverse weather event (August 2022)

The series of adverse weather fronts that crossed New Zealand between 11 July and 31 July 2022 has been declared to be an emergency event for the purposes of section 183ABA of the Tax Administration Act 1994. The emergency event applies to the following areas that have been affected by floods, damaging high winds, and disruption to infrastructure: Canterbury, Gisborne district, Northland, Otago, and Wairoa district. This section allows the Commissioner to remit use-of-money interest payable on late tax payments following emergency events.

The declaration applies to taxpayers who were significantly adversely affected in the specified regions by the disruption caused by the weather fronts and who were unable to pay their tax on time, such as: PAYE, and FBT due 20 July; and provisional tax, and GST due 28 July 2022. Taxpayers may apply for interest remission once their tax returns and payments are up to date. Different rules apply in cases of financial hardship.

The declaration commenced 15 August 2022, and expires 30 September 2022.

Find out more about Inland Revenue's tax relief measures at **ird.govt.nz**

DEP108: Tax depreciation rates for hydrofraise rigs

Note to Determination DEP108:

The Commissioner has been asked to consider what depreciation rate should apply for hydrofraise rigs, used to build diaphragm (water blocking) type retaining walls. Diaphragm walls are often constructed in wet areas where groundwater will tend to flood an excavated area. The construction of the wall must therefore keep water out, as well as being strong enough to stop surrounding ground from collapsing into the excavation.

A basic hydrofraise rig usually consists of a tracked "crawler" crane, suited to boggy unstable ground. The crane is designed to move the cutting head around the site and lower and raise it as required for cutting operations. It differs from a normal crane in several ways:

- It is purpose built for hydrofraise operations
- It includes computerised telemetry equipment that is linked to instruments on a guide frame. This equipment is used to monitor and control the direction of the cutting head to ensure that the wall design is adhered to;
- Has a large reel on the back to transport the slurry pipe which connects to the slurry plant and other reels for the smaller hydraulic hoses which connect to the cutting rig drive motors and adjusting mechanisms within the head.

Other components of equipment used for diaphragm wall construction (for example, slurry tanks, other storage tanks, mixing platform and separate pumping equipment) are viewed by the Commissioner as separate items of plant, not covered by the proposed depreciation rate for hydrofraise rigs.

Determination DEP108: Tax Depreciation Rates General Determination Number 108

This determination may be cited as "Determination DEP108 Tax Depreciation Rates General Determination Number DEP108: Hydrofraise rigs available for use in the ordinary course of business".

1. Application

This determination applies to taxpayers who own items of depreciable property of the kind listed in the tables below:

This determination applies to the 2021/22 and subsequent income years.

2. Determination

Pursuant to section 91AAF of the Tax Administration Act 1994, the general determination will apply to the kind of items of depreciable property listed in the table below by:

- Adding into the "Contractors, Builders & Quarrying" industry category, the new asset class, estimated useful life, and general diminishing value and straight-line depreciation rates listed below:

Asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
Hydrofraise rigs (including hydromills, trench cutters and hydrofraise cranes)	10	20	13.5

3. Interpretation

In this determination, unless the context otherwise requires, words and terms have the same meaning as in the Income Tax Act 2007 and the Tax Administration Act 1994.

Dated at Wellington on the 8th July 2022.

Rob Falk
Technical Lead, Legal Services – Technical Standards

DETERMINATION FDR 2022/01 – Two Trees Global Equity Macro Fund – Class Z

A type of attributing interest in a foreign investment fund for which a person may use the fair dividend rate method (Units in the Two Trees Global Equity Macro Fund – Class Z).

Any investment by a New Zealand resident investor in units in the Two Trees Global Equity Macro Fund – Class Z, to which none of the exemptions in section EX 29 to 43 of the Income Tax Act 2007 apply, is a type of attributing interest for which the investor may use the Fair Dividend Rate method to calculate Foreign Investment Fund income for the interest.

Reference

This determination is made under section 91AAO(1)(a) of the Tax Administration Act 1994. This power has been delegated by the Commissioner of Inland Revenue to the position of Technical Lead – Legal Services under section 7 of the Tax Administration Act 1994.

Discussion (which does not form part of the determination)

Units in the Two Trees Global Equity Macro Fund – Class Z ("Two Trees Fund"), to which this determination applies, are attributing interests in a foreign investment fund ("FIF") for New Zealand resident investors when none of the exemptions in section EX 29 to EX 43 of the Income Tax Act 2007 apply.

Under EX 32 of the Income Tax Act 2007 an exemption may arise for an Australian Unit Trust and a New Zealand resident investor so that a person's rights in the unit trust in an income year are not an attributing interest. The determination will only apply when an attributing interest arises.

New Zealand resident investors are required to apply the FIF rules to determine their tax liability in respect of their Two Trees Fund investments each income year.

The investments held by the Two Trees Fund may consist predominantly of financial arrangements providing funds to a person. In addition, some New Zealand resident investors may hedge their attributing interests in the Two Trees Fund back to New Zealand dollars. Therefore, section EX 46(10)(cb) of the Income Tax Act 2007 could apply to prevent those investors from using the fair dividend rate method in the absence of a determination under section 91AAO of the Tax Administration Act 1994.

The policy intention is that the FDR method of calculating FIF income should not be applied to investments that provide a New Zealand resident investor with a return similar to a New Zealand dollar denominated debt investment. It is appropriate for the Commissioner to take into account the whole of the arrangement in ascertaining whether an investment in a FIF provides the New Zealand-resident investor with a return akin to a New Zealand dollar denominated debt investment.

Notwithstanding that the Two Trees Fund may have assets predominantly comprising financial arrangements and New Zealand resident investors may enter into related New Zealand dollar hedging arrangements, the overall arrangement contains sufficient risk so that it is not akin to a New Zealand dollar-denominated debt instrument. Accordingly, I consider it is appropriate for New Zealand resident investors to use the fair dividend rate method to calculate FIF income from their attributing interest in the Two Trees Fund.

Scope of determination

This determination is issued on the basis of information provided to the Commissioner before the date of this determination and applies to an attributing interest in a FIF held by New Zealand resident investors in a non-resident issuer where:

1. The non-resident issuer:
   - Is known at the date of this determination as the Two Trees Global Equity Macro Fund;
   - Invests in long and short positions in equity, bond, currency and commodity markets, as well as making other investments;
   - Is operated with separate classes of units.

2. The attributing interest consists of class Z units issued in the Two Trees Fund, a class of units that provides an interest in the underlying assets of the Two Trees Fund that predominantly (by notional exposure) invests in long and short positions in equity, bond, currency and commodity markets, as well as making other investments. Exposure to these markets is primarily achieved through the use of exchange traded futures or over the counter derivatives such as currency forward contracts. For the purposes of covering the derivative positions, the Two Trees Fund also holds cash and cash equivalents which may mean that the underlying assets of the fund predominantly (i.e. 80% or more by value at a time in the income year) consist of financial arrangements; and
3. The investment interest attributable to the class Z units are subject to currency hedging arrangements undertaken by the New Zealand resident investors for the purposes of eliminating exchange rate risk on a highly effective basis.

This determination is made subject to the following conditions:

1. The investment in the Two Trees Fund is not part of an overall arrangement that seeks to provide the New Zealand resident investor with a return that is equivalent to an effective New Zealand dollar denominated interest exposure.
2. The absolute value of the Two Trees Fund's notional derivative exposure must not fall to 20% or less of its Net Asset Value for a continuous period of 45 days. Should this occur, the determination ceases to apply from the first day of the following quarter.

Interpretation

In this determination unless the context otherwise requires:

"Fair dividend rate method" means the fair dividend rate method under section YA 1 of the Income Tax Act 2007;

"Financial arrangement" means financial arrangement under section EW 3 of the Income Tax Act 2007;

"Foreign investment fund" means foreign investment fund under section YA 1 of the Income Tax Act 2007;

"Two Trees Fund" means an Australian Unit Trust known at the date of this determination as the Two Trees Global Equity Macro Fund – Class Z.

Determination

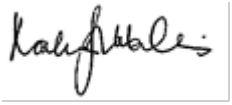
This determination applies to an attributing interest in a FIF, being a direct income interest in the Two Trees Fund. This is a type of attributing interest for which the investor may use the fair dividend rate method to calculate FIF income from the interest.

Application Date

This determination applies for the 2023 and subsequent income years.

However, under section 91AAO(3B) of the Tax Administration Act 1994, this determination does not apply for a person and an income year beginning before the date of the determination unless the person chooses that the determination apply for the income year.

Dated this 1st day of August 2022.



Nathan Wallis
Technical Lead

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**

BR Prd 22/08: Ministry of Education

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

Name of person who applied for the Ruling

This Ruling has been applied for by the Ministry of Education (the Ministry).

Taxation Laws

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

This Ruling applies in respect of s CW 36.

Arrangement to which this Ruling applies

The Arrangement is the payment of scholarships by the Pacific Education Foundation to eligible tertiary students under the Tulī Takes Flight Scholarships (Tulī Scholarships) and Pacific Education Fund Scholarships (PEF Scholarships) programmes. The Ministry of Education funds the scholarships.

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

Background

1. The Pacific Education Foundation is a body corporate with perpetual succession that was established by the Pacific Education Foundation Act 1972. The purpose of the foundation is to "promote and encourage the better education of Pacific people and to provide financial assistance for that purpose" (s 5 of the Pacific Education Foundation Act 1972).
2. The Ministry provides the funding to the foundation for the scholarships. As at 1 April 2022, Ministry scholarship funding is $490,000 per year for the Tulī Scholarships and $75,000 per year for the PEF Scholarships. This funding may be increased in later years and can be used only for the scholarships.

Tulī Scholarships

3. The Tulī Scholarships acknowledge the ongoing importance of education for Pacific families and communities. The scholarships are awarded annually to New Zealand citizens of indigenous Pacific heritage to undertake tertiary education in New Zealand with New Zealand tertiary providers.
4. As at 1 April 2022, the Tulī Scholarships are for $10,000 to $30,000 per year and are awarded for one, two or three years in the categories of:
   - New to Study (first year);
   - Continuing Study or Training (second year onwards); and
   - Career Changer (at least 12 years since leaving school).
5. The scholarship categories and value of the scholarships may change in later years. However, the scholarship recipients will always be subject to the eligibility criteria and terms and conditions outlined in [7] to [9].
6. The scholarship payment can be used for paying fees for scholarship study, as well as living costs (such as accommodation, transport and childcare) and course-related costs (such as materials and equipment).

7. To be eligible for a Tulī Scholarship, an applicant must:
   - be enrolled for full-time (or limited full-time as defined by StudyLink) scholarship study;
   - be of indigenous Pacific Island descent;
   - be a New Zealand citizen or permanent resident;
   - have been living in New Zealand for three years or more at the time of applying for the scholarship; and
   - be undertaking the scholarship study in New Zealand at a New Zealand tertiary organisation at New Zealand Qualifications Framework levels 4 to 10, where tertiary organisation for this purpose means a university, polytechnic, wānanga or registered private training establishment providing tertiary and/or vocational education in New Zealand.
8. In addition to fulfilling the eligibility criteria, applicants are assessed on their motivations for applying, including why they are pursuing tertiary education, their financial needs, and their expected role and involvement in their community or region to make it a better place for Pacific peoples.
9. Additional terms and conditions are as follows:
   - The recipient must pass at least 75 percent of their scholarship study each academic year.
   - The recipient may no longer be eligible to receive the scholarship payment if they withdraw from the scholarship study without first obtaining written approval.
   - The recipient must provide two progress reports to the Pacific Education Foundation for each year of their scholarship period, including any official results or transcript. They should include an outline of their future career or study plans if it is their last scholarship payment.
   - The recipient must be enrolled with a pastoral care provider at the tertiary organisation they attend.
   - The recipient is expected to be involved in ongoing publicity to promote the Tulī Scholarships.
10. The recipients are not employed by the Pacific Education Foundation. Apart from some involvement in ongoing publicity noted above, recipients are under no obligation to provide any services to the foundation.

PEF Scholarships

11. The PEF Scholarships are awarded annually to encourage Pacific students into further education. As at 1 April 2022, the scholarships are awarded in two categories:
    - undergraduate scholarships of $5,000 each; and
    - postgraduate scholarships of $10,000 each.
12. The scholarship categories and value of the scholarships may change in later years. However, the scholarship recipients will always be subject to the eligibility criteria and terms and conditions outlined in [13] and [14].
13. To be eligible for a PEF Scholarship, an applicant must be:
    - a New Zealand citizen, permanent resident or resident of at least three years
    - of indigenous Pacific Island descent
    - currently enrolled full time in an undergraduate or postgraduate degree programme at a New Zealand–registered tertiary education organisation; and
    - involved in their local and, where possible, Pacific communities.
14. Applicants are also assessed on their:
    - ability to communicate effectively and motivations for pursuing tertiary education;
    - current qualifications;
    - financial or other needs;
    - academic success and personal achievement; and
    - experiences leading and working with people, including, where possible, Pacific communities.
15. The scholarship amount is paid out as a monthly stipend over six months from June to November to assist with the recipients' studies. Recipients are asked to provide general feedback on how their studies are going and how the award is supporting their studies. There are no other written terms and conditions for PEF Scholarships.

16. The recipients are not employed by the Pacific Education Foundation and are under no obligation to provide any services to the foundation.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

(a) To the extent a scholarship payment the Pacific Education Foundation makes to a student under the Arrangement is income, it is exempt income of the student under s CW 36.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 March 2022 and ending on 6 July 2025.

This Ruling is signed by me on the 6th day of July 2022.

Howard Davis
Group Leader (Tax Counsel Office)

INTERPRETATION STATEMENT

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 22/04: Claiming depreciation on buildings

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

Summary

1. This Interpretation Statement provides guidance to building owners on when they can claim depreciation on buildings. Until the 2010/2011 income year building owners could claim depreciation on buildings that they used, or had available for use, in deriving income or in carrying on a business for that purpose. This changed from the 2011/2012 income year when the depreciation rate for long-life buildings was reduced to 0%. In 2020, the depreciation rate for long-life non-residential buildings was increased.[1] The rate for residential buildings remained at 0%. For this reason, it is important to understand the difference between a residential and a non-residential building. While both "residential building" and "non-residential building" are defined terms, the Act contains no definition of "building".
2. The Commissioner issued a statement in 2010, IS 10/02 "Meaning of "building" in the depreciation provisions".[2] This concluded that the meaning to be given to a "building" was its ordinary or conventional meaning. That ordinary meaning is distinguished from a "wider" meaning which would include all built structures. It is also different from a "narrower" meaning which would exclude items that provide a specialised setting or a specialised function or were integrated with plant. The Commissioner considers that this ordinary meaning is still the appropriate meaning to be given to "building" for depreciation purposes.
3. In *Mercury*[3], the High Court endorsed the Commissioner's "working definition of building" but acknowledged there might be rare cases where a building should be treated as other than a building for depreciation purposes[4]. Such cases will be rare as the definitions of "plant" and "commercial fit-out" exclude items that are structural elements of a building.
4. A non-residential building is defined to exclude a residential building. A residential building is based on the concept of a dwelling. However, it also includes smaller scale operations where a building may provide short-stay accommodation, if the building together with other buildings on the same land, has less than 4 units for separate accommodation. In contrast, buildings that supply accommodation on a commercial scale, such as hotels and motels, fall within the definition of a non-residential building. Therefore, a "non-residential building" will encompass commercial and industrial buildings and certain buildings that may provide residential accommodation on a commercial scale.
5. However, where a building is used for both residential and non-residential purposes, it will only have a depreciation rate of greater than 0% if it is predominantly or mainly used for non-residential purposes: it is effectively an all-or-nothing test.
6. This statement sets out how to claim depreciation and the impact of the legislative amendments that took effect from the 2011/2012 and 2020/2021 income years.

[1] The increased rate is 2.0% for owners using the diminishing value method and 1.5% for those owners using the straight-line method.

[2] *Tax Information Bulletin*, Vol 22, No 5 (June 2010): 24.

[3] *Mercury NZ Limited v CIR* (2019) 29 NZTC 24,014.

[4] Discussed from [73].

Introduction

7. This Interpretation Statement updates and replaces IS 10/02 "Meaning of 'building' in the depreciation provisions"[5]. At the time IS 10/02 was issued, buildings were depreciable property with a range of rates of depreciation applying. This changed from the 2011/2012 income year when the depreciation rate for long-life buildings (those with an estimated useful life of 50 years or more) was reduced to 0%.
8. The depreciation rate for non-residential buildings was increased in 2020 in the COVID-19 Response (Taxation and Social Assistance Urgent Measures) Act 2020. The amendments apply from the 2020/2021 income year and retained the 0% depreciation rate for residential buildings.
9. Since the publication of IS 10/02, legislation has changed, depreciation determinations have been issued for certain classes of buildings or structures, and the High Court decided *Mercury*[6]. These developments affect how the depreciation rules now apply to buildings and other structures.
10. This statement steps through the depreciation rules that apply to buildings and explains how to distinguish between a residential building and a non-residential building. Before dealing with the specific categories of buildings, it looks at what is meant by the term "building" and how to distinguish between a building and other items of depreciable property attached to the building.
11. Importantly, this statement examines each of the following:
    - How the depreciation regime works including the meaning of depreciable property and depreciation loss.
    - The meaning of "non-residential building" including the meanings of building, residential building, and commercial building.
    - How to distinguish between a building and items attached to the building.
    - How to find the right depreciation rate for the item of depreciable property.
    - How the rules apply to a disposal of the building or a change of use.
12. This statement also looks at how the 2020 changes apply in certain special cases:
    - How to determine the opening value for the 2020/2021 income year for buildings that were depreciable property in the 2010/2011 income year.
    - What happens to the pool[7] of commercial fit-out for which deductions have been taken under s DB 65.
    - How the rules apply to buildings that were "grandparented structures" and improvements to those structures.

Depreciation regime overview[8]

13. Depreciation deductions are allowed for the loss in value of depreciable property used, or available for use, in deriving income or carrying on a business for that purpose. The starting point for a deduction for such a loss is s DA 1. Section DA 1 allows a deduction for an amount of expenditure or "depreciation loss" when it is incurred in deriving income or carrying on a business for that purpose.
14. Subpart EE of the Act determines the amount of the depreciation loss and the timing of the deduction. It also provides for the amount and the timing of depreciation recovery income that arises on the disposal or change of use of depreciable property (see from [116]).
15. Section EE 1(2) provides that a depreciation loss arises for a person, in an income year, for an item of property if all the following apply:
    - The person owns the item (ss EE 2 – EE 5).
    - The item is depreciable property (ss EE 6 – EE 8).
    - The item is used, or is available for use[9], by the person in the income year (s EE 1(2)(c)).
16. The amount of depreciation is calculated under ss EE 9 – EE 11.

[5] *Tax Information Bulletin*, Vol 22, No 5 (June 2010): 24.

[6] *Mercury NZ Limited v CIR* (2019) 29 NZTC 24,014.

[7] See the discussion from [133] relating to the "pool" of embedded commercial fit-out created under s DB 65.

[8] A quick reference schedule of the key provisions relevant to claiming depreciation on buildings and fit-out of those buildings is included at the end of the statement.

[9] The Commissioner discusses the meaning of "available to use" in Interpretation Statement IS 22/01: Income Tax – deductibility of costs incurred due to COVID-19", April 2022.

Meaning of "own"

17. Sections EE 2 – EE 5 set out what is meant by ownership of the item of depreciable property. These provisions cover situations where property is jointly owned, where property is subject to reservation of title arrangements, and lessee's improvements.

Meaning of depreciable property

18. A building and items attached to a building can be depreciable property if they meet the requirements of s EE 6(1). Section EE 6(1) defines depreciable property as property that, in normal circumstances, will decline in value while it is used, or available for use, in deriving income or carrying on a business for that purpose. It cannot be property that is described in s EE 7.
19. Section EE 7 describes what is not depreciable property. It specifically excludes land, but does not exclude buildings, fixtures and certain land improvements if they meet the requirements of s EE 6(1). The depreciable land improvements set out in schedule 13 include bridges, chimneys, dams, retaining walls and wharves. Therefore, buildings and certain built structures may be depreciable property.
20. When a person has depreciable property that is used or available for use in the income year, they are allowed a deduction for the depreciation loss. While a person may choose not to take a deduction, they will be treated as having taken the deduction unless they elect to treat the item of property as not depreciable. Being treated as claiming the deduction means the depreciable value of the property will be adjusted (reduced) by the amount of the allowable deduction. This is the property's adjusted tax value.[10] This is important because if the person later disposes of the property, or if a change of use occurs, the person may have depreciation recovery income. In calculating the amount of that depreciation recovery income, the person is treated as having claimed depreciation (see further details on depreciation recovery income from [116]).

Election to make property not depreciable

21. A building owner may have commercial reasons for choosing to make a building not depreciable. For example, the building owner may be intending to dispose of the property or to change its use within a short time. The building owner can choose that the property is not depreciable by making an election under s EE 8. The Commissioner recently published QB 21/11 "Elections not to depreciate commercial buildings". It explains the rules around:
    - when a building owner needs to make such an election
    - how they must make an election
    - whether they can amend an election
    - whether they can make a retrospective election.
22. Importantly, QB 21/11 concludes that while a person can make a retrospective election any time after they acquire the property, they cannot make it after they have claimed a deduction for depreciation loss.

Non-residential buildings

23. A building may be depreciable property, as it will decline in value while it is used or available for use in deriving income or carrying on a business for that purpose. However, the mechanism that Parliament used in 2010 for disallowing depreciation on buildings was to reduce the depreciation rate on long-life buildings to 0%.
24. In March 2020, the COVID-19 Response (Taxation and Social Assistance Urgent Measures) Act 2020 reintroduced depreciation deductions for certain long-life buildings by increasing the depreciation rate for non-residential buildings. The definition of building was repealed and new definitions of "residential building" and "non-residential building" were introduced with effect from the 2020/2021 income year.
25. Non-residential building is defined in s YA 1.

> **non-residential building** means a building that is not a residential building.

26. Therefore, a non-residential building is a "building" that is not a "residential building".

[10] "Adjusted tax value" and calculating depreciation deductions is discussed from [87].

Meaning of "building"

27. The definition of "building" in s YA 1, which applied before the 2020/2021 income year, was as follows.

> **building,** in subparts EE and EZ, does not include –
>
> (a) a grandparented structure:
>
> (b) commercial fit-out

28. This definition did not state what a building was but instead stated what was not a building for the purposes of the depreciation provisions.

Ordinary meaning

29. The *Concise Oxford English Dictionary11* defines "building" as:

> 1. a structure with a roof and walls.
>
> …

30. The *Shorter Oxford English Dictionary12* defines "building" as:

> 1. A thing which is built, a structure, an edifice, a permanent, fixed thing built for occupation, as a house, school, factory, stable, church, etc.
>
> …

31. These definitions indicate that a building, within its ordinary meaning, is a permanent fixed structure providing shelter, such as a house, school, factory but the definitions also support a wider interpretation of "building"; that is, a permanent fixed structure or thing that is built. The appropriate meaning to be given to the word depends on its context. Mason J, in *R v Marks ex Australian Building Construction Employees' and Builders Labourers' Federation*, at 485[13] noted that the meaning of the word depended on its context:

> The meaning of the word "building" depends very much on the context in which it is found. In some circumstances it means a building providing accommodation for people; in others it will include a structure accommodating something whether it be animals, materials, plant or machinery; at other times it signifies a mere structure or edifice e.g. a bridge, a tank or a tower. …

Characteristics of a building

32. Many cases have considered the meaning of "building". The following characteristics are common to a building within the ordinary or conventional meaning of the word:

- A building is a structure of considerable size that is intended to be permanent, or at least to endure for a considerable time[14]. Because of changes over time in the types of materials that are used to construct buildings, it is not possible to be definitive about the design or the type of materials that characterise a building; a building will be constructed using the building materials of the day[15]: However, given the requirement of permanence, a building would usually be constructed of durable materials intended to last for a significant period.
- A building is also permanent in the sense that it is generally designed to be located permanently on the site where it stands. However, a structure need not be attached to the ground on which it stands to be a building. In *Stevens v Gourley* a shop that was fixed to the ground by its own weight and was not easily removed to another site was a building. A structure that can easily be moved from place to place will not be a building within the conventional meaning[16].
- A building in the conventional sense is enclosed by walls and a roof that is designed to provide shelter[17]: In *Moir v Williams* Lord Esher MR commented (at p 270) *"what is ordinarily called a building … is an enclosure of brick or*

[11] (12th ed), Oxford University Press, 2011.

[12] (6th ed, Oxford University Press, 2007).

[13] *R v Marks ex Australian Building Construction Employees' and Builders Labourers' Federation*, (1981) 147 CLR 471.

[14] *Stevens v Gourley* (1859) 7 CBNS 99.

[15] *Clarke v Wilkie* (1977) 17 SASR 134.

[16] *Melfort Danceland v Star City (Rural Municipality)* [1977] 3 WWR 737.

[17] *Moir v Williams* [1892] 1 QB 264; *Hilderbrandt v Stephen* [1964] NSWR 740; *Australian Building Construction Employees' & Builders Labourers' Federation v Dillingham Australia Ltd* (1982) 58 FLR 170.

stonework covered in by a roof". In *Hilderbrandt v Stephen*, Jacobs J discussed the meaning of "building" and stated (at p 742) with reference to *Moir v Williams* "*in its ordinary meaning, it at least involves the concept of a structure with a roof and a support for that roof*".

- A building can function independently of any other structure. In *Barat v Minister of National Revenue*[18] the Court held that a parking garage was a building given the size and permanence of it and the fact it was self-contained and functioned independently of any other structure. However, a building need not be a physically separate structure. In *Spencer v Soljan,* McMullin J noted, at p 292:[19]

  > [s]ome semi-detached structures such as terraced houses comprising individual dwellings may each be buildings for the purpose of [section 91 of the Town and Country Planning Act 1977] despite their contiguity with and physical attachment to one another.

- A structure need not legally be part of the land on which it stands to be a building: *R v Swansea City Council ex p Elitestone Ltd.*[20]

33. The courts have also accepted that in deciding whether a structure is a building within the conventional meaning, it is appropriate to ask whether a reasonable person would regard the structure as a building based on its appearance and function. In *Harris v De Pinna21* a "reasonable person" test was applied. Chitty J stated at p 249:

    > The proposition I am about to put again is not a decisive one, but I will put it. Would an ordinary man, with a reasonable knowledge of the English language, passing this structure speak of it as a building? I agree that, it is only putting it in a somewhat different form. The question in substance is one of fact and viewing it as a whole and having regard particularly to the model, and by no means disregarding the photographs which I have seen, I have come to the conclusion that this is a structure, but not a building within sect. 3 of the Prescription Act.

34. In *Metals & Alloys Co v Ontario Regional Assessment Commissioner22* Arnup J.A. stated at [50]:

    > "Building", however, is an ordinary English word, and in this statute should be given the meaning an ordinary person would attribute to it. What we have in this case looks like a building. It is almost identical to its neighbouring structure, which is admittedly a building. It is built like a building. It is used like a building. … The only reasonable conclusion, in my view, is that it is a building.

35. The Commissioner's view is that for the depreciation provisions, the term "building" has its ordinary or conventional meaning. Building should not have a narrower meaning to exclude certain buildings, such as those that provide a specialised setting or are integrated with plant, or a wider meaning to include all built structures. This was the view reached in IS 10/02 and formed the basis of the Commissioner's submissions in *Mercury v CIR*[23].

36. In *Mercury* the issue was whether the "turbine halls" at two geothermal powerstations fell within the definition of "building" or whether they were to be treated as part of the gantry cranes situated within the halls and depreciated as plant. This was important because, if the turbine halls were found to be buildings, the relevant depreciation rate at that time would have been 0%. In contrast, if the items were found to be part of the gantry cranes, the rate would have been 9.6%. The turbine halls had the outward appearance of buildings. The Court found that the turbine halls were buildings.

37. The Commissioner had submitted that the meaning to be given to "building" was its ordinary or conventional meaning. The Court agreed, and stated that the Commissioner's description of a building in IS 10/02 was "a good working definition of building":

    > [51] In 2009, before the enactment of the 2010 Budget Act, the Commissioner issued an interpretation statement on the meaning of "building". The Commissioner examined the meaning through the legislation, case law and dictionary sources, and came to the following common description of "building":
    >
    > (a) A building is a structure of considerable size.
    >
    > (b) A building is permanent in the sense that it is designed to be located permanently on the site where it stands. A building is fixed to the land on which it stands. However, a building need not be legally part of the land on which it stands.

[18] *Barat v Minister of National Revenue* [1991] 2, CTC 2,360.

[19] *Spencer v Soljan* (1984) 10 NZTPA 289.

[20] *R v Swansea City Council ex p Elitestone Ltd* (1993) 66 P & CR 422.

[21] *Harris v De Pinna* (1886) LR 33 Ch D 238.

[22] *Metals & Alloys Co v Ontario Regional Assessment Commissioner* (1985) 36 RPR 163.

[23] *Mercury NZ Limited v CIR* (2019) 29 NZTC 24,014.

(c) A building is enclosed by walls and a roof.

(d) A building can function independently of any other structure. However, a building is not necessarily a physically separate structure.

(e) The appearance and function of the structure are relevant in determining whether a structure is a building for depreciation purposes (that is, whether the structure looks like the conventional idea of a building and is designed for the uses to which conventional buildings are ordinarily put). It is appropriate to ask whether a reasonable person would regard the structure as a building.

[52] Without examining in detail the cases and other sources the Commissioner used to come to this definition, I consider it is a good working definition of building. Not all of these indicia need be present in each case. For example, a carpark building often does not have a roof.

38. Therefore, for depreciation purposes the meaning to be given to "building" is its ordinary or conventional meaning. This means a "non-residential building" is a "building", under the ordinary meaning of the word but it is not a "residential building".

Meaning of residential building

39. The definition of residential building in s YA 1 is based on the concept of a dwelling but is extended to include certain buildings used for short-stay accommodation.

> **residential building—**
>
> (a) means a dwelling; and
>
> (b) includes a building intended to ordinarily provide accommodation for periods of less than 28 days at a time, if the building, together with other buildings on the same land, has less than 4 units for separate accommodation

Residential building – para (a) – dwelling

40. Section YA 1 defines "dwelling" as follows:

> **dwelling—**
>
> (a) means any place configured as a residence or abode, whether or not it is used as a place of residence or abode, including any appurtenances belonging to or enjoyed with the place:
>
> (ab) despite paragraph (a), **for the purposes of subpart EE and the definitions of commercial building, commercial fit-out, and residential building**, means any place used predominantly as a place of residence or abode, including any appurtenances belonging to or enjoyed with the place:
>
> (b) **does not include any of the following**, in whole or part:
>
> (i) a hospital:
>
> (ii) a hotel, motel, inn, hostel, or boardinghouse:
>
> (iii) a serviced apartment for which paid services in addition to the supply of accommodation are provided to a resident, and in relation to which a resident does not have quiet enjoyment, as that term is used in section 38 of the Residential Tenancies Act 1986:
>
> (iv) a convalescent home, nursing home, or hospice:
>
> (v) a rest home or retirement village, **except** to the extent that, in relation to a relevant place, it is, or can reasonably be foreseen to be, occupied as a person's principal place of residence for independent living:
>
> (vi) a camping ground:
>
> (c) despite paragraph (b)(iii) and (v), for the purposes of section CB 16A (Main home exclusion for disposal within 5 years) and the definition of residential land—
>
> (i) includes a serviced apartment described in paragraph (b)(iii):
>
> (ii) does not include, in whole or part, a rest home or retirement village
>
> [emphasis added]

41. A "dwelling" is a place of accommodation or residence of an individual. A dwelling includes "any appurtenances belonging to or enjoyed with the place". This means that a garage or sleepout or other minor building on the land that belongs to the dwelling or is enjoyed as part of the dwelling will form part of the dwelling.
42. A dwelling does not include most buildings that provide residential accommodation on a commercial scale, or that provide short- or long-term care of the person. Specifically, the definition of dwelling excludes hotels, motels and boardinghouses, and places that provide care such as hospitals, rest homes, hospices and retirement villages. However, a residential place in a retirement village in which the person lives independently is a dwelling.
43. For depreciation purposes, the relevant definition of dwelling is para (ab). This is also the relevant definition for the meaning of residential building, commercial building and commercial fit-out. For these purposes, a dwelling is any place **used** predominantly as a place of residence or abode. This definition focuses on the **use** of the building. This differs from the definition in para (a) that would include a place configured as a dwelling but not used for that purpose.
44. In addition, for the depreciation rules and the meaning of residential building, it is the "predominant" use of the building that will determine whether it is a dwelling and therefore a residential building.
45. The *OED Online*[24] defines the words "predominantly" and "predominant" as:

> **Predominantly**:
>
> In a predominant manner; to a predominant degree; (in later use) esp. primarily, largely, chiefly, for the most part.
>
> **Predominant:**
>
> 1 (b) Constituting the main, most abundant, or strongest element; prevailing, preponderating.

Characterising a building – an all-or-nothing test

46. The definitions of "residential building" and "non-residential building" do not use words of apportionment such as "to the extent". Instead, the legislation focuses on the building's predominant or main use. Therefore, if a building is predominantly or mainly used as a place of residence, it will be a residential building and subject to a depreciation rate of 0%. In contrast, a building that is predominantly or mainly used for non-residential purposes will be depreciable at the appropriate non-residential building rate.
47. While a building may be used for both residential and non-residential purposes it will only have a depreciation rate of greater than 0% if it is predominantly or mainly used for non-residential purposes. Because the test is based on the building's predominant use, it is effectively an all-or-nothing test. In most cases it will be clear what the predominant or main use of a building is. If it is not clear, then the building owner will need to consider the circumstances of the building to determine its predominant or main use.
48. One method for determining a building's main use may be based on comparing the floor area used for residential purposes with the area used for non-residential purposes. If a floor area test is used, then areas of common use, such as lobbies, hallways and entranceways used by both residential and non-residential occupants, would also need to be factored into the apportionment. See *Example 6 – Mixed-use commercial* building.

Retirement village – independent living arrangements

49. Buildings within rest homes and retirement villages will generally be non-residential buildings. This is because they are excluded from the definition of "dwelling". However, places within a rest home or retirement village occupied under independent living arrangements are not excluded from the definition of dwelling and therefore may be a residential building. Independent living is defined in s YA 1 as:

> **independent living** means occupancy of a place under an arrangement that—
>
> (a) does not have a level of compulsory care:
>
> (b) has a level of compulsory care that is merely incidental to the occupancy

[24] "Predominantly: Oxford University Press, December 2021, www.oed.com/view/Entry/149891. Accessed 11 January 2022; "predominant": Oxford University Press, December 2021, www.oed.com/view/Entry/149890. Accessed 11 January 2022.

50. Retirement villages will generally comprise a collection of buildings. As the classification of a building as residential or non-residential building is dependent on the building's predominant use, each building within a rest home or retirement village will need to be considered individually. For example:
    - a building that is ***wholly used*** to provide residential accommodation under independent living arrangements (such as a villa or apartment) will be a residential building and the depreciation rate will be 0%.
    - a building that is ***predominantly used*** to provide hospital care, or assisted care (with compulsory care requirements or where those requirements are not merely incidental to the occupancy) will be a non-residential building.
    - a ***mixed-use building*** might have some independent living apartments within a building that also provides hospital care, or assisted care. In this case, whether the building is a residential building or a non-residential building will depend on its predominant use.[25]

No requirement that a dwelling is a primary residence

51. The definition of dwelling is not limited to buildings that are used as a person's primary residence or home. In addition, there are no requirements for any degree of permanency of occupation, or full-time use. This means that a dwelling will include a holiday home that a person lets out for residential purposes from time-to-time. Therefore, a dwelling can include a building that is used to provide short stay accommodation.

Residential building – para (b) – short stay accommodation

52. The second part of the definition of residential building defines the boundary between residential and non-residential buildings that provide short stay accommodation. Specifically, a building will be a residential building "*if the building, together with other buildings on the same land, has less than 4 units for separate accommodation*". The inclusion of "less than 4 units" excludes larger commercial operations. But it makes it clear that the term "residential building" includes buildings that are used exclusively for short-term accommodation, such as Airbnb properties, if there are less than 4 units on the same land.

Distinguishing between buildings and items attached to a building

53. After establishing whether the building is a non-residential building, the next step is to understand whether items attached to a building are separate items of depreciable property or whether they are treated as part of the building. This is because an owner of depreciable property needs to establish the correct rate of depreciation that applies to the "item of property".

Identifying the item of property

54. The Commissioner's general position on identifying an item of property is based on a three-step test that was set out in IS 10/01 "Residential rental properties – Depreciation of items of depreciable property".[26] The test is a guide to identifying whether an item is a separate asset or part of a larger asset. Although IS 10/01 dealt with depreciation of residential rental properties, the Commissioner's view is that the principles generally apply to commercial properties.

55. Later statements have consistently applied the three-step test. It was summarised in QB 20/01 "Can owners of existing residential rental properties claim deductions for costs incurred to meet Healthy Homes standards?"[27] Again this statement focusses on residential rental properties and income tax deductions, but it provides general guidance on the approach to be taken for identifying the relevant asset:

    Step 1: Determine whether the item is in some way attached or connected to the building. If so, go to step 2. If not, the item will be a separate asset.

    Step 2: Determine whether the item is an integral part of the residential rental property such that a residential rental property would be considered incomplete or unable to function without the item. If so, the item will be part of the residential rental building. If not, go to step 3.

    Step 3: Determine whether the item is built-in or attached or connected to the building in such a way that it is part of the "fabric" of the building. If so, the item will be part of the residential rental building. If not, the item will be a separate asset.

[25] For further discussion on the meaning of independent living arrangements see "Clarifying that certain building fit-out is depreciable property" *Tax Information Bulletin* Vol 23, No 1 (Feb 2011) [68].

[26] *Tax Information Bulletin*, Vol 22 No 4 (May 2010), 16.

[27] *Tax Information Bulletin*, Vol 32 No 7 (August 2020), 126.

56. For non-residential buildings, the legislation distinguishes between a building and other items of depreciable property. In 2010, after the depreciation rate for longer-life buildings was reduced to 0%, legislation was introduced to ensure that building fit-out in a commercial or non-residential building should continue to be separately depreciable. This meant that it could continue to be depreciated at a rate of more than 0%.

Defining commercial building – commercial fit-out – plant

57. The 2010 changes introduced new definitions of "commercial fit-out", "commercial building" and "plant", and amended the definition of building to exclude commercial fit-out. These definitions distinguish between a building and other items of depreciable property that may be able to be separately depreciated.

58. The definition of commercial building in s YA 1 is as follows:

> **commercial building** means a building that is not, in part or in whole, a dwelling, unless use as a dwelling is a secondary and minor use.

59. Whether a building is a "commercial building" is relevant to whether the fit-out of that building is separately depreciable. If a building provides some residential accommodation but this is a secondary and minor use of the building, then the building will still be a commercial building.

60. The relevant definitions of commercial fit-out and plant are contained in s YA 1 as follows:

> **commercial fit-out** means an item to the extent to which it is—
>
> (a) plant attached to a commercial building, but not used inside a dwelling within the commercial building:
>
> (b) attached to, and non-structural in relation to, a building, if the item is not used for weatherproofing the building and—
>
> (i) is not used in relation to, and is not part of, a dwelling within the building; or
>
> (ii) is used in relation to, but is not part of, a dwelling within the building, and the building is a commercial building.
>
> …
>
> **plant** does not include an item that is structural in relation to a building

61. Commercial fit-out refers to items which are attached to certain buildings. Importantly, commercial fit-out does not include any item which is structural to a building or used for weatherproofing a building. The definition also draws a distinction between the type of building that the item is attached to and how and where the item is used within the building. There are four important distinctions:

- Plant (non-structural) attached to a commercial building is commercial fit-out and depreciable, but **not plant used inside a dwelling** within that building (para (a) of the definition).
- Other items which are attached to **any** building (and non-structural and not used for weatherproofing) are commercial fit-out and depreciable if they are:
  - **not part of** a dwelling within a building, and
  - **not used in relation to** a dwelling within the building.

  These are items that are part of and used in wholly commercial areas of a building (para (b)(i) of the definition). For example, a predominantly residential apartment building with commercial retail or a hospitality business on the ground floor could have depreciable fit-out within those commercial areas.
- Items that are attached to a commercial building (and non-structural and not used for weatherproofing) and are **used in relation to a dwelling but are not part of the dwelling** are also commercial fit-out and depreciable. These are items situated in a commercial building (a building which is predominantly non-residential as any residential use is minor or secondary). This would include fit-out in shared or common spaces outside of the residential/dwelling areas.
- Attached items within the dwelling are not commercial fit-out. Whether attached items within the dwelling are depreciable will depend on whether the items are separate items of depreciable property[28].

[28] "Interpretation Statement: IS 10/01: Residential rental properties – depreciation of items of depreciable property", *Tax Information Bulletin* Vol 22, No 4 (May 2010).

62. *Example 6 – Mixed-use commercial building* explains how the commercial fit-out rules apply in a building that provides some residential accommodation as a secondary and minor use.

Building structure

63. These definitions help to define what will be treated as part of a non-residential building for depreciation purposes. Anything that is a structural part of the building, including an item of plant that is structural to the building, will be considered part of the building. This is because the definition of "plant" excludes an item that is structural in relation to a building. In addition, anything that is non-structural but attached to a building and used for weatherproofing, is excluded from being treated as "fit-out" and therefore treated as part of the building.

64. The word "structural" has a range of meanings. The *Concise Oxford English Dictionary*[29] defines "structural" as meaning:

> **Structural:** relating to or forming part of a structure.

65. The *Shorter Oxford English Dictionary*[30] includes the following definition:

> **Structural:**
>
> 1 (b) Of or pertaining to the structure of a building etc. as distinguished from its decoration or fittings.

66. The *OED Online*[31] also includes the following definition:

> **Structural**, (noun):
>
> A component or material having a structural or load-bearing role, esp. in a building.

67. From the above definitions, an item that is structural to a building is an item with a structural or load-bearing role, forming a necessary part of the structure of the building. However, it could also be an item that "relates to" the structure, or a "necessary part of the structure … as distinct from its decoration or fittings". For depreciation purposes, an item that is attached to a building but non-structural and used for weatherproofing is part of the building, and not a separately depreciable item of commercial fit-out. Therefore, an item that relates to the weathertightness of a building, although it may not be structural from an engineering perspective, will be regarded as part of the building structure.

68. When these definitions were being proposed, officials described the structure of a building as including:[32]

- the foundations;
- the building frame;
- floors;
- external walls;
- cladding;
- windows and doors;
- stairs;
- the roof;
- load-bearing structures such as pillars and load-bearing internal walls.

69. Therefore, a non-residential building will include the component elements of a building that are structural or used for weatherproofing the building. See [133] for a discussion about embedded "commercial fit-out" and deductions taken under s DB 65.

[29] 12th ed, Oxford University Press, 2011.

[30] 6th ed, Oxford University Press, 2007.

[31] www.oed.com/view/Entry/389383. Accessed 17 December 2021.

[32] Officials' Issues Paper *Post-Budget Depreciation Issues*, Inland Revenue, August 2010: 5.

Distinguishing a building from plant

70. The distinction between an item of plant and a building was central to the High Court case of *Mercury*. The case considered whether the "turbine halls" at two geothermal powerstations fell within the definition of "building" or whether they were to be treated as part of the gantry cranes, situated within the halls. The structural support to the gantry cranes formed part of the structure of the building. The turbine halls had the ordinary appearance of a building and functioned in the way a building functions. The High Court noted that the legislation was clear that what might otherwise be "fit-out" or "plant" will be treated as part of the building if it is structural to the building:

> [48] … There is nothing in the legislation that gives any signal that a building for purposes of the depreciation provisions is anything other than a building in the ordinary sense of the word. It is also clear that what might otherwise be "fit-out" or "plant", if it is "structural" in relation to an (industrial) building, is part of the building and is not treated as plant or fit-out for depreciation purposes. On the other hand, plant merely attached to an industrial building is not included or treated as a building for tax purposes and can be separately treated as plant.

71. Questions can arise if the building does more than provide the ordinary characteristics and functions of a building and provides a specialised setting for a particular process or is integrated into an industrial process. An issue is whether that structure is still a building for depreciation purposes.

72. The Commissioner's view is that if a building provides a specialised setting, it will still be a building for depreciation purposes. In *Mercury,* one of the considerations was whether a structure that had the appearance of a building, but that provided *more* than a specialised setting for an industrial process, could be treated as something other than a building. In particular, the question was whether a structure that is materially integrated with the "operating" plant and equipment within it, or with the industrial process carried on within the structure, should be treated as plant.

73. The definition of plant excludes an item that is structural to a building. Therefore, it is the Commissioner's view that if the item has the appearance and characteristics of a building and functions like a building, then such an item will not be plant. However, a building structure that is integrated into an industrial process may be a building for which a different rate of depreciation is appropriate. This is because the process may affect the building's estimated useful life, and this forms part of the formula for calculating the relevant depreciation rate. The legislation provides for this by allowing an owner to apply for a special rate of depreciation for the item, or a provisional rate for a new item for which the Commissioner has not set a general economic rate. Alternatively, they could ask that the Commissioner consider setting a general economic rate for this new item of depreciable property. Special rates and provisional rates are discussed from [111].

74. Examples of determinations the Commissioner has issued for particular asset classes are:

- Determination PROV 24 for mushroom factory buildings and plant[33];
- Determination PROV 26 for hydroelectric powerhouses[34].

Rare cases – industrial structures

75. In *Mercury*, the Court was referred to Determination PROV 26 in which the Commissioner states a "hydroelectric powerhouse is integral to the function of a hydroelectric power scheme's purpose of generating hydroelectricity". The Court noted that the language of PROV 26 was similar to the arguments raised in *Mercury*, about a structure being integrated with a function or industrial process. The court acknowledged that there might be "rare situations" where a building is "part of the apparatus" of the business and might not be treated as a building for depreciation purposes:

> [76] However, I consider that in those rare situations where a building is part of the apparatus for carrying on a business, it might be considered for purposes of the depreciation provisions of the Act to not be a building. Interestingly, that language is similar to the language the Commissioner used in PROV 26 when she said a hydro turbine hall is "integral to the function of the production of hydropower".

76. On the particular facts, the geothermal turbine halls did not fall into this rare situation. The Court considered the turbine halls were buildings in the ordinary sense of the word. In addition, while the turbine halls provided support for machinery, they were not an integral part of the production process to such a degree that they should be considered to be plant.

> [81] …The turbine hall providing "support" for machinery is quite different to its being **an integral part of the production process to such a degree that it can be treated as plant**. [Emphasis added]

[33] "Determination PROV 24: Provisional depreciation rate for mushroom factory buildings and plant", *Tax Information Bulletin* Vol 24, No 9 (1 October 2012): 7.

[34] "Determination PROV 26: Depreciation rate for hydroelectric powerhouses", *Tax Information Bulletin* Vol 27, No 4 (May 2015): 11.

77. The Court commented that a "hydro powerhouse" might be one of those structures that fell into this rare situation. Features the Court noted in support of this view included that they are usually situated in rivers, are attached to a dam and have water flowing through them or part of them:

> [90] I would add that it strikes me there are likely some material differences between hydro and geothermal powerhouses, including that most hydro powerhouses are situated in rivers and have water flowing through them, or part of them. They are attached to the dam itself. This would tend to suggest that the hydro powerhouse would fall into the limited category of structures that are integrally involved in the production process, similar to the cool store and dry dock examples.

78. For an item to fall within the category of the "rare case" referred to in *Mercury*, it will need to be considered on its own facts. That will require considering the structure against the characteristics typical of a building, as well as the function of the structure. If it is found to be a building, then that will, in most cases, be the appropriate classification for depreciation purposes. The function or use of the building or structure will be a relevant factor to determine the appropriate depreciation rate.

Summary – building

79. In summary, a building for depreciation purposes has its ordinary or conventional meaning as set out in [37] above. The building will comprise all the structural components that are necessary to fulfil the meaning of a building and will generally include the items listed at [68]. The building will also include items attached to it that are non-structural but are used for weatherproofing the building. A building's structure may provide structural support for an item of plant. However, having this function does not mean that the building is something other than a building. It will still be a building for depreciation purposes.

80. To have a depreciation rate of greater than 0%, a building must be a non-residential building.

Summary – non-residential building

81. In summary, a non-residential building is a building that is not a residential building. Therefore, a building will be **either** a non-residential building **or** a residential building which is determined based on the building's predominant use. A building owner cannot apportion a mixed-use building for depreciation purposes. Because the test is based on the building's predominant use, it is effectively an all-or-nothing test. Depreciation of the building at a rate greater than 0% is only available to non-residential buildings. This is shown in Figure 1: Distinction between residential and non-residential buildings.

Figure 1: Distinction between residential and non-residential buildings

Building	
• Building has its ordinary meaning. It includes anything that is structural to the building or used for weatherproofing the building • Whether a building is residential or non-residential is an all-or-nothing test	
Residential building	**Non-residential building**
• Means any place used mainly as a place of residence • Includes any garages or sheds included with the building • Includes places used as residences for independent living in retirement villages and rest homes • Includes short-stay accommodation where less than 4 separate units	• Includes buildings used predominantly for commercial and industrial purposes but not residential buildings • Includes hotels, motels, inns, boardinghouses, serviced apartments and camping grounds • Includes retirement villages and rest homes (except places used as residences for independent living) • Includes short-stay accommodation where 4 or more separate units

82. The non-residential building will include any plant or commercial fit-out that forms a structural part of that building or any item attached to the building and used for weatherproofing the building.

83. A building owner can depreciate commercial fit-out if it is in a wholly non-residential building. Commercial fit-out is also depreciable in a mixed-use building in the following circumstances:
    - In a **predominantly non-residential building,** the fit-out must not be used in a dwelling within the building but it can be used in relation to the dwelling, such as fit-out of the common areas of the building.
    - In a **predominantly residential building,** the fit-out must be in a wholly non-residential area of the building. Items of shared fit-out such as in the common areas of the predominantly residential building are not included in the definition of commercial fit-out.

84. Figure 2: Can depreciation be claimed? shows the tax treatment for non-residential buildings, residential buildings and commercial fit-out.

Figure 2: Can depreciation be claimed?

Item	Can depreciation be claimed?		
	Building	**Commercial fit-out**	**Shared fit-out**
Wholly non-residential building	Yes	Yes	N/A
Predominantly non-residential building	Yes	Yes	Yes
Predominantly residential building	Yes (but at 0%)	Yes	No
Wholly residential building	Yes (but at 0%)	N/A	N/A

85. This statement will now explain how to calculate depreciation deductions for non-residential buildings.

Claiming depreciation on non-residential buildings

Depreciation method

86. Owners of non-residential buildings can claim depreciation deductions on buildings that they use or have available for use for deriving income or in carrying on a business for that purpose. The depreciation methods available for building owners to choose from are either the straight-line (SL) or diminishing value (DV) methods (s EE 12).

Amount of depreciation loss

87. Under s EE 14, the amount of depreciation loss available as a deduction is **the lesser of** the amount calculated under ss EE 15 or EE 16:
    - Under s EE 15, the amount is the item's adjusted tax value (ATV) before the deduction of an amount of depreciation loss for the income year.
    - Under s EE 16, the amount of depreciation loss available as a deduction is based on a standard calculation:

      Annual rate × value or cost × months/12

88. This means the amount of the deduction for depreciation loss can never be greater than the ATV of the item at the beginning of the income year.

89. The "annual rate" is the annual rate that, in the income year, applies to the item of depreciable property under the depreciation method that the person uses. This rate is expressed as a decimal (s EE 16(3)). The "annual rate" is defined in s EE 61 as meaning the annual depreciation rate applying to an item of depreciable property that a person owns. Depreciation rates are discussed from [102].

90. The "value or cost" is:
    - For a person using the DV method, the item's ATV at the end of the income year before the deduction of an amount of depreciation loss for the item for the income year (s EE 16(4)(a)). Finding the item's starting ATV is discussed below from [92]. For further discussion on the opening tax book value for the 2020/21 income year, see from [131].
    - For a person using the SL method, the item's cost to the person **excluding** expenditure for which the person is allowed a deduction under a provision of the Act outside subpart EE (s EE 16(4)(b)(ii)). For further discussion on the meaning of "cost" see from [99].

91. The "months /12" refers to the number of months in the year that the item is used or available for use. Whether a building is "available for use" is a factual question. A building owner will need to consider this each year when calculating the amount of depreciation to be claimed. A building may be considered available for use if it was not being used because it was being repaired, if it was used, or available for use, immediately before the repairs commenced. For further discussion on the meaning of "available for use" see IS 22/01.

Starting ATV

92. To calculate the amount of depreciation loss relating to any item of depreciable property, the owner must first establish the starting value of the item, which will be the item's opening ATV. This will apply when an owner first acquires an item for use in deriving assessable income or carrying on a business for that purpose. It will also apply when an owner changes the use of an item, such as, from private to business use or where a residential building is converted to commercial use.
93. Section EE 55 provides that the ATV for an item of depreciable property is the amount calculated using the formula provided in s EE 56. That formula is as follows:

Base value – total deductions

Base value

94. The base value of the item is set in ss EE 57 – EE 59 and s EZ 22(1). In the context of buildings and building fit-out it is noted:
    - Section EE 58 does not apply to buildings.
    - Section EE 59 applies to petroleum-related depreciable property.
    - Section EZ 22(1) sets the base value for items owned continuously since the 1992-93 income year (the base value is the tax book value for the 1992-93 income year).
    - Section EE 57 sets the base value in all other cases.
95. Therefore, for buildings, the base value will be set under s EE 57 as the cost of the item. The meaning of "cost" is discussed from [99].
96. For other items of depreciable property (such as fit-out), the base value will be calculated under ss EE 57 or EE 58. This depends on whether the owner acquired it for use in deriving assessable income and whether the owner has previously been allowed a deduction for depreciation loss for the item:
    - If the owner did not acquire it to use or have available for use in deriving assessable income (or in carrying on a business for that purpose) and has not been allowed a depreciation deduction, the base value is the market value of the item when the person starts to use it or when it becomes available for use (s EE 58(2)). This will generally apply to an item when there is a change of use from private use to business use, and it could apply to the fit-out of a residential building that is changing its use to non-residential.
    - If the owner acquired it to use in deriving assessable income or would have been allowed a deduction for depreciation loss, then the base value for the item will be set under s EE 57. This will be the cost of the item, subject to the adjustments to cost discussed from [99].

Total deductions

97. The "total deductions" are calculated under s EE 60. This includes the amounts of depreciation loss that a person claimed (or was allowed) for the item in the period beginning on the date the item was acquired and ending on the last day of the previous income year. This is subject to some adjustments. For example, if a building owner receives compensation or insurance for an event damaging the building, and the amount received exceeds the expenditure that the building owner incurs because of the event, the excess amount would be deducted from the building's ATV.
98. Therefore, if a building owner changes a building's use from residential to non-residential, the starting ATV for an item of depreciable fit-out will be:
    - the market value of the item at the time that it becomes available for use (s EE 58(2)) if a deduction for depreciation loss had never been allowed for the item since it was acquired by the owner.
    - the item's cost (as the base value) less any deductions that were allowed for the item, if a deduction for depreciation loss would have been allowed for the item at any time since it was acquired by the owner.

Meaning of cost

99. "Cost" is not defined in the Act but is accepted generally as "*that which must be given to acquire something*".[35] "Cost" for depreciation purposes is limited to the initial cost of the item, together with set-up and installation costs. However, s EE 16(4)(b)(ii) excludes from "cost" any "*expenditure for which the person is allowed a deduction under a provision of this Act outside this subpart*". For a full discussion on the meaning of "cost", see IS 18/06 Income tax – treatment of costs of resource consents.[36]

100. In addition, the "cost" of the item is reduced by subtracting the amount of any goods and services tax (GST) input tax included in the cost of the item, on the supply to the person (s EE 54).

101. Special rules apply to transfers between associated persons. The general rule is that when a person (person A) acquires an item of property from an associated person, the "cost" of that property for depreciation purposes is limited to the lesser of the cost of that property to person A and the cost to the associated person (s EE 40(7)). Some exceptions apply. For example, it does not apply if person A acquires the property on a settlement of relationship property. It may not apply if the Commissioner decides that it is appropriate to use the cost of the item to person A (s EE 40(8)(a)). The circumstances in which this might be allowed are set out in Standard Practice Statement SPS 07/05[37].

Depreciation rates

102. The next step is to find the correct annual depreciation rate for the item of property. This is important because there are different rates of depreciation that can apply to an item of property depending on when it was acquired or when it first became available for use in deriving income or carrying on a business for that purpose.

- The Commissioner has a depreciation rate finder and calculator for finding the correct rate for buildings and other items of depreciable property. This calculator can be used for buildings acquired after 19 May 2005, or other items of depreciable property acquired after 1 April 2005. Alternatively, these rates are published in *IR 265*. The IR 265 also has a useful step-by-step guide to finding the correct rate for the item of depreciable property.
- If the building was acquired prior to 19 May 2005 or if the other item was acquired prior to 1 April 2005, the relevant depreciation rate can be found in the tables of historic rates published in IR 267 *Historic depreciation rates – for assets acquired before 1 April 2005*. This publication sets out the relevant depreciation rates as follows:
  - Part 1 – Depreciation rates before 1993
  - Part 2 – 1993 to 2005 asset rates: Industry categories
  - Part 3 – 1993 to 2005 rates: Asset categories.

103. For further guidance on how to select the correct rate of depreciation or on changing the rate of depreciation that applies to the item of property see QB 15/03: "*Income Tax- changing to a different depreciation rate for an item of depreciable property*".

Annual rates of depreciation

104. To calculate depreciation for an income year a person must use the appropriate "annual rate" that applies to the item. As noted above, "annual rate" is defined in s EE 61 as being "*... the annual depreciation rate applying to an item of depreciable property that a person owns*". Section EE 61 then points to the relevant provisions that set the rate:

- For buildings and other property acquired in the 1995/1996 income year or later (and that is **not** an international aircraft, fixed life intangible property, a patent or design registration), the rate is set under s EE 31.
- For property acquired after 1 April 1993 and before the end of the 1994/1995 income year, the rate is set by s EZ 13.
- For "excluded depreciable property"[38], the rate is set by s EZ 15.

105. Section EE 31 provides that the annual rate that applies to an item of property is the item's economic, special or provisional rate, subject to some exceptions.

[35] *Tasman Forestry Limited v CIR* (1999) 19 NZTC 15,147 (CA).

[36] *Tax Information Bulletin* Vol 30 No 11 (December 2018): 10, 15.

[37] SPS 07/05: Transfer of depreciable property between associated persons – section EE 33* of the Income Tax Act 2004 (September 07), *Tax Information Bulletin*, Vol. 19, No. 9 (October 2007). *Section EE 33 of the Income Tax Act 2004 is now s EE 40 of the Income Tax Act 2007.

[38] Excluded depreciable property is defined in s EE 64 and includes property that a person used or had available for use (other than as trading stock) before 1 April 1993.

Economic rates

106. Generally, the depreciation rate for an item of property acquired for use in deriving income, or that becomes available for such use, will be the item's economic rate. Economic rates were introduced from 1 April 1993 and applied to items of depreciable property acquired from that date. The formulas for setting economic rates were revised in 2005 and applied from the 2005/06 income year. The current table of rates includes the economic rates set by the Commissioner for different classes of assets based on the estimated useful life of that class of asset, and based on its use in particular industries.

107. Section EE 26 points to the relevant provisions which set the formula for particular assets. For example, the formula for setting an economic rate for buildings is found in s EE 28. The economic rate for buildings is set under s EE 28(4) as:

$$1 \div \text{estimated useful life}$$

Exceptions to the general economic rate – residential buildings

108. Annual rates for an item of property are sometimes specifically set. Specific rates are set in s EE 31 for residential buildings. For residential buildings, the rate is set at 0%, **whenever the building was acquired** (s EE 31(2)(d), s EE 31(3)(c), s EE 61(3B) and s EE 61(7B)).

Exceptions to the general economic rate – non-residential buildings

109. For non-residential buildings, the annual depreciation rate that applies will depend on the date that the building was acquired by the building owner, the type of building and the way in which the building is used. As buildings are very often acquired with land, see the discussion on when land is acquired in QB 17/02: "Income tax – date of acquisition of land, and start date for 2-year bright-line test".

110. The "Buildings (non-residential buildings)" rate of 2% (DV) and 1.5% (SL), which applies from the 2020/2021 and subsequent income years is a rate set by the COVID-19 Response (Taxation and Social Assistance Urgent Measures) Act 2020 (s 39). These are specific rates set for a generic class of non-residential buildings. These rates apply to buildings with an estimated useful life (EUL) of 50 years or more. The rates are default rates, which means they apply unless more specific rates have been set for the type of building, or a special or provisional rate applies to the building. The current table of rates includes specific rates that have been set for buildings that the Commissioner has determined have a different EUL. For example:

- A more specific rate is set for a chemical works building, which has an EUL of 33.3 years. The rate for the chemical works building will depend on whether the chemical works building was acquired on or before 30 July 2009, or after that date.
- Similarly, a more specific rate is set for buildings with prefabricated stressed-skin insulation panels. Buildings constructed using these materials may be found in some coolstores, meat and fish processing facilities. As buildings may sometimes be partially constructed using these materials, the Commissioner has provided guidance on the buildings that fall within this class in QB 17/01: "Depreciation treatment for 'Buildings with prefabricated stressed-skin insulation panels'"[39].
- A building with steel or steel and timber framing (default class) acquired after 19 May 2005, had a rate that applied to the 2010/2011 income year of 3% (DV) or 2% (SL). From the 2011/2012 and subsequent income years, the rate for a building of that construction is set at 0%. However, for the 2020/2021 and subsequent years the owner of the building will have to apply the default rate for a non-residential building of 2% (DV) or 1.5% (SL) because there is no specific rate set for buildings with steel or steel and timber framing for the 2020/2021 and subsequent years.

Special rates or provisional rates

111. A special rate can be set for an item of depreciable property but not for a residential building or for "excluded depreciable property"[40] (s EE 35). The need for a special rate could arise if an economic rate is available for the item but the way in which the item is used in deriving income means that the EUL of the item differs from the one set by the Commissioner under the general economic rate for the item. A person can apply for a special rate by following the process outlined under s 91AAG of the Tax Administration Act 1994 (IR 260B).

[39] QB 17/01: "Depreciation treatment for 'Buildings with prefabricated stressed-skin insulation panels'", *Tax Information Bulletin*, Vol 29, No 4 (May 2017).

[40] See n 38.

112. A provisional rate can also be applied for under s 91AAG of the Tax Administration Act 1994, except if it is for an item of "excluded depreciable property" (IR 260A). A person can apply for a provisional rate if a new asset class is required. For example, the Commissioner has issued provisional determinations for buildings that have been constructed using special types of materials or have processes carried out within them that affect the building's useful life (for example, Determination PROV24[41] and Determination PROV22[42]. In these cases, no appropriate asset class existed.

Improvements to buildings

113. A building owner who makes an improvement to a building[43] can choose to treat the improvement as part of the building or as a separate item of depreciable property. However, in the year in which the improvement is made it is treated as a separate item of depreciable property (s EE 37(2)). This is for the purpose of claiming the part year depreciation loss for the improvement. For further information on improvements, see IS 10/01 paragraphs [167] to [177].

114. In the following year, the building owner can either continue to treat the improvement as a separate item of depreciable property or choose to treat it as part of the building (s EE 37(3)(a)). In either case the appropriate rate of depreciation for the improvement will be the building rate.

115. If the building owner chooses to treat the improvements as part of the building, the building owner must add the improvements' ATV at the start of the income year to the building's ATV at the start of the income year (s EE 37(5)). If using the straight-line method, the building owner must also add the improvements' cost to the building's cost:

> *Improvement treated as part of item*
>
> (5) For the purposes of subsection (3)(a), a person may choose to treat the improvement as part of the item of depreciable property that was improved. They must do 1 of the following for the first income year, after the income year in which they made the improvement, in which they use the improvement or have it available for use:
>
> (a) if they use the diminishing value method for the item, add the improvement's adjusted tax value at the start of the income year to the item's adjusted tax value at the start of the income year:
>
> (b) if they use the straight-line method for the item,—
>
> (i) add the improvement's adjusted tax value at the start of the income year to the item's adjusted tax value at the start of the income year; and
>
> (ii) add the improvement's cost to the item's cost.

Disposal or change of use

116. When a building owner has a building or item of commercial fit-out that is treated as depreciable property and the owner either disposes of the property or certain events occur, they may have depreciation recovery income, or additional depreciation loss.

117. At the time the disposal or other event occurs, depreciation recovery income will arise if the consideration for the item of depreciable property exceeds the ATV of the item. However, the amount of depreciation recovery income cannot be more than the total amount of deductions for depreciation loss that a person had available for the item of property.

118. "Consideration" for this purpose is subject to some adjustments. For example:

- If the amount of consideration is less than market value, the amount that the person derives is treated as being the item's market value (s EE 45(3)). Section EE 45(3) is subject to some qualifications. For example, it does not apply to a transfer under a relationship agreement[44].

[41] Determination PROV24: Mushroom factory buildings and plant; issued 1 October 2012, *Tax Information Bulletin*, Vol 24, No 9 (October 2012): 7.

[42] Determination PROV22: Provisional depreciation rate for Dairy Plant Dry Store Buildings; issued 27 February 2012, *Tax Information Bulletin* Vol 24, No 3 (April 2012): 8.

[43] For example, a common improvement to a building in New Zealand is seismic strengthening. If treated as a separate asset, the costs related to the strengthening will be depreciable at the relevant building rate.

[44] A "relationship agreement" is defined in s YA 1, and includes an agreement made under Part 6 of the Property (Relationships) Act 1976 and an order made by a court under s 25 of that Act.

- The consideration may be subject to the purchase price allocation rules. Purchase price allocation rules were introduced with effect from 1 July 2021 to reinforce and extend existing provisions requiring parties to a sale of business assets with different tax treatments to adopt the same allocation of the total purchase price to the various classes of assets for tax purposes[45]. However, they do not apply when the total consideration for the purchased property is less than $1 million, or less than $7.5 million if the only purchased property is residential land and accompanying chattels.

119. The events that trigger depreciation recovery income arising are set out in s EE 47. They include:
    - A change of use of an item that means a person is not allowed a deduction for depreciation loss for that item for the next income year. This includes a change of use of commercial fit-out and a change in the status of a building related to an item of commercial fit-out (s EE 47(2)).
    - Damage to a building or the neighbourhood of the building that causes the building to be useless for deriving income, and the building is demolished or abandoned for future demolition (s EE 47(4)).
    - When a person acting under statutory authority acquires a property (s EE 47(7)).
    - When a lessee who owns fixtures and improvements to the land disposes of their interest under a lease under ss EE 4 or EE 5 (s EE 47(8)).

Depreciation recovery income

120. The amount of the depreciation recovery income is treated as derived in the income year in which it is calculated. It is calculated under s EE 48 as being the lesser of the amount of depreciation loss that a person has been allowed for the item, or the amount by which the consideration exceeds the item's ATV.

EE 48 Effect of disposal or event

Amount of depreciation recovery income

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

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

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

Amount for subsection (1)(b)

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

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

Definition of items in formula

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

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

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

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

[Emphasis added]

[45] The rules (contained in ss GC 20 and GC 21) are explained in *Tax Information Bulletin* Vol 33, No 6 (July 2021): 28.

121. Importantly, in calculating the amount of depreciation loss in s EE 48(1)(b), the formula takes account of "the total of the amounts of depreciation loss for which the person has been allowed for the item". Depreciation loss for this purpose means the amount that a person was entitled to claim, as calculated under subpart EE. This means that it includes an amount that a person could have claimed whether they in fact claimed such deductions.

122. If the amount of depreciation loss claimed by the building owner was in error, for example, where an incorrect depreciation rate had been used, the building owner might be able to make an adjustment to the prior assessments[46]. In QB 15/03: "Income Tax – changing to a different depreciation rate for an item of depreciable property", the Commissioner discusses when a change to a depreciation rate can be made and when it is required to be made. Whether an amendment can be made to correct past periods will depend on the particular facts and circumstances of the case. In some cases a person can make an adjustment in their next return (see s 113A of the Tax Administration Act 1994), and in other situations the person will need to request that the Commissioner exercise their discretion under s 113 of the Tax Administration Act 1994 (see Standard practice statement SPS 20/03: Requests to amend assessments).

123. Example 1 – *Commercial building sold* demonstrates how to calculate depreciation recovery income on the sale of a commercial building.

Example 1 – Commercial building sold

The owners of Buildings A and B have not separately depreciated the commercial fit-out.

	Cost price	Accumulated depreciation loss	Adjusted tax value (ATV)	Sale price
Building A	$1,000,000	$200,000	$800,000	$1,500,000
Building B	$1,000,000	$200,000	$800,000	$900,000

Building A

The consideration (sale price) exceeds the ATV by $700,000.

The amount of the depreciation loss available for the building was $200,000.

The amount of the depreciation recovery income is $200,000, as the lesser of the two amounts.

Building B

The consideration exceeds the ATV by $100,000

The amount of the depreciation loss available to the building was $200,000.

The amount of the depreciation recovery income is $100,000, as the lesser of the two amounts.

124. Depreciation recovery income can also arise when there is a change of use of a building or commercial fit-out. In *Example 8 – Partial change of use – commercial fit-out*, a building leased for commercial purposes has a change of use when a floor of the building is let as a residential tenancy.

125. The depreciation recovery income formula also takes account of other specific deductions (under s CZ 11 and s DB 64), neither of which relate to buildings. It does not include deductions taken under s DB 65 (see [130] to [136] for further discussion on s DB 65: the allowance for certain commercial buildings). Therefore, building owners should ensure that the deductions claimed under s DB 65 are adjusted in the calculation to ensure that there is not an over-recovery of depreciation loss. If depreciation recovery income is simply calculated as the difference between the consideration received on disposal and the ATV, the amount of the s DB 65 deductions will need to be added back to prevent an over-recovery of depreciation loss.

126. An example of a depreciation recovery income calculation where s DB 65 deductions had been claimed is included in *Example 4 – Commercial building owned since 2009 – s DB 65 deductions*.

[46] See QB 15/03: "Income Tax- changing to a different depreciation rate for an item of depreciable property", *Tax Information Bulletin*, Vol 27, No 4, May 2015:30, ss 113 and 113A of the Tax Administration Act 1994 and SPS 20/3: Requests to amend assessments *Tax Information Bulletin*, Vol 32, No 6, July 2020:11.

Disposing of residential buildings

127. Although the depreciation rate for a residential building has been set at 0% since the 2011/12 income year, depreciation recovery income could arise on the disposal of a residential building. This will occur if the building is depreciable property of the owner and depreciation loss had been allowed for that building up to and including the 2010/11 income year.

Example 2 – Disposal of a residential rental property

Bob and Shirley own a residential rental property which they bought in August 2008 for $625,000. A registered valuation at the time of purchase valued the land at $250,000 and the value of the improvements at $375,000. Included in the value of the improvements were the following chattels: carpets, curtains and blinds, electric stove, dishwasher and washing machine with a total value of $9,500. This meant that the value of the building for depreciation purposes was $365,500 ($375,000 – $9,500 = $365,500).

In the 2009 to 2011 income years, they claimed depreciation on the building as follows:

Value improvements $365,500	Depreciation (DV 3%)	ATV
Original cost		$365,500.00
2009 (6 complete months)	$5,482.50	$360,017.50
2010	$10,800.53	$349,216.97
2011	$10,476.51	$338,740.46
2012-2020	0.00	$338,740.46
Total (accumulated depreciation loss)	$26,759.54	

In 2021, Bob and Shirley sell the rental property for $1,250,000.00. Because the consideration is less than $7.5m and the sale is only of residential land and chattels, Bob and Shirley (and the purchaser) are not required to make a purchase price allocation in accordance with s GC 21. However, Bob and Shirley still need to establish the amount of the sale price that relates to the building, and other items of depreciable property that are included in the sale. If that amount exceeds the amount of the ATV of the relevant items, then there will be depreciation recovery income.

Bob and Shirley obtained a registered valuation for the property before marketing the property. The valuation of the land and buildings combined was $1,150,000. The land value was $495,000 and the value of improvements (including chattels of $20,000) was $655,000. Based on this valuation, Bob and Shirley worked out that the building accounted for 55.22% of the total valuation. They decided to use the same percentage to establish the portion of the sale price which is attributable to the building:

2021 Registered valuation:

Value of improvements $635,000/$1,125,000 = 55.22%

Apportionment of sale price:

$1,250,000 × 55.22% = $690,250 (value of improvements)

The amount of depreciation recovery income is the smaller of either:

- the original cost price of the building ($365,500) less the ATV ($338,740.46) = $26,759.54 (being all the depreciation claimed)
- the sale price ($690,250) less the ATV ($338,740.46) = $351,509.54

Therefore, the amount of depreciation recovery income is the smaller amount of **$26,759.54.**

Additional depreciation loss on certain disposal events

128. In some circumstances under the depreciation rules, additional depreciation loss is available. This occurs if the amount of the consideration received (actual or deemed) is less than the ATV. However, for buildings this only arises where the building is rendered useless and demolished, or abandoned for demolition. In addition, the cause of the damage to the building needs to have been a natural event (such as a flood or earthquake) and beyond the control of the building owner (or their agent or a person associated with them).

129. Additional depreciation loss on disposal is available to the owners of grandparented structures. This is provided for in s EZ 23BD which provides that s EE 48(2) applies if the item is a grandparented structure. Grandparented structures are discussed from [137].

EE 48 Effect of disposal or event

Amount of depreciation loss

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

Income year of depreciation recovery income

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

When subsection (2) does not apply

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

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

(b) [Repealed]

(c) the damage is caused—

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

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

Special cases – opening ATV, s DB 65 and grandparented structures

130. Several special rules provide for the transition from the 2019/20 income year to the 2020/21 income year for building owners who had previously claimed depreciation for their buildings or commercial fit-out. These rules relate to:

- the opening tax book value for buildings owned in the 2010/11 income year
- deductions that had been taken under s DB 65 for commercial fit-out
- buildings that had been treated as "grandparented structures".

Opening tax book value from the 2020/21 income year

131. For building owners who have claimed depreciation deductions for the building before the 2011/12 income year, the opening book value is the ATV of the building as at the end of the 2010/11 income year, **less** any deductions that were taken under s DB 65 in the period up to the 2019/20 income year, **plus** any non-deductible capital expenditure incurred on the building from the end of the 2010/11 income year through until the beginning of the 2020/21 income year. This is shown in Figure 3: Opening book value for 2020/21 income year.

Figure 3: Opening book value for 2020/21 income year

Start	Building ATV at end of 2010/11
Plus	Improvements between 2010/11 and 2020/21
Subtract	Section DB 65 deductions claimed
Equals	Opening book value for 2020/21

132. *Example 3 – Commercial building owned since 2009* shows how this applies to the owner of a commercial building who has been using the building for deriving income since the 2008/09 income year. See [133] for further details about s DB 65.

Example 3 – Commercial building owned since 2009

Jack and Jill Property Ltd bought a unit in a commercial building in the 2008/09 income year to use for their lawnmower sales and service business. They claimed deductions for depreciation loss in the 2009-11 income years. In 2016 they replaced the existing single glazed aluminium-framed windows and side door in the office area with new double glazed PVC units at a cost of $15,500. The ATV at the end of the 2011 year was $228,000 and the non-deductible capital expenditure (the improvements) incurred since then was $15,500. No amount was claimed under s DB 65. Therefore, the opening book value for 2021 is $243,500.

Embedded commercial fit-out – section DB 65

133. At the time the rules relating to commercial fit-out were introduced some building owners had commercial fit-out that they had not separately depreciated but had instead depreciated at the building rate. As commercial fit-out was intended to be depreciable, a special rule was introduced that allowed certain commercial building owners to make a one-off adjustment to create a "pool asset" that could continue to be depreciated by way of a special allowance under s DB 65. The value of the "starting pool" was calculated under s DB 65(4). This was 15% of the building's ATV (less the value of any later acquired fit-out for which depreciation deductions had been claimed). The amount of the deduction available to this "pool" under s DB 65(2) was 2%:

> **DB 65** Allowance for certain commercial buildings
>
> *Deduction*
>
> (2) Except as provided by subsection (6), the person is treated as having a loss for the income year equal to the amount calculated using the formula—
>
> starting pool × 0.02 × whole months ÷ 12.

134. Section DB 65 was repealed in 2020 when depreciation deductions were reintroduced for long-life commercial buildings. To allow depreciation deductions for that fit-out to continue, s EE 56 was amended to permit building owners to adjust the ATV of the building. As noted above, s EE 56 provides that an item's ATV is its "base value" less "total deductions".

135. The base value for a building is provided for in s EE 57 and is the cost of the item (subject to some adjustments). The deductions are listed in s EE 60(1). The 2020 amendments added a further deduction in s EE 60(1)(d):

> (d) The total amount of previous deductions under s DB 65 (Allowance for certain commercial buildings).

136. Therefore, the nominal "pool asset", as with the allowance for the embedded commercial fit-out, ceased to exist from the beginning of the 2020-21 income year. The total amount claimed under s DB 65 is adjusted against the ATV of the building at the end of the 2010/11 income year. However, building owners will need to remember that if the building is later disposed of there needs to be a further adjustment for the s DB 65 deductions because they are not included in the depreciation recovery income calculation. This is illustrated *in Example 4 – Commercial building owned since 2009 – s DB 65 deductions*.

Example 4 – Commercial building owned since 2009 – s DB 65 deductions

Junior Wholesalers Ltd bought a warehouse for storing imported car part spares in the 2008/09 income year. At the time Junior acquired the building, the vendor had allocated $50,000 to partition walls and other assorted fit-out. Junior decided that it was simpler to claim depreciation on the building and the fit-out at the building's depreciation rate. The building's ATV at the end of the 2010/11 income year was $450,000.

From the 2011/12 income year, under s DB 65(4), Junior was able to create an asset "starting pool" of "commercial fit-out":

Starting pool = Building's ATV × 15%

= $450,000 × 0.15

= $67,500

Junior claimed deductions under s DB 65 on the "pool" at 2% (straight-line) for each of the years 2011/12 to 2019/20:

$67,500 × 0.02 × 12 (whole months)/12 = $1,350.00

No capital expenditure was incurred on the warehouse during that period. The deductions claimed were as follows:

Commercial fit-out pool s DB 65		
Opening value "pool"		$67,500.00
2011/12	$1,350.00	$66,150.00
2012/13	$1,350.00	$64,800.00
2013/14	$1,350.00	$63,450.00
2014/15	$1,350.00	$62,100.00
2015/16	$1,350.00	$60,750.00
2016/17	$1,350.00	$59,400.00
2017/18	$1,350.00	$58,050.00
2018/19	$1,350.00	$56,700.00
2019/20	$1,350.00	$55,350.00
Total deductions under s DB 65	$12,150.00	

For the 2020/21 income year, the opening ATV of the building will be:

Closing ATV 2011 + non-deductible capital expenditure – total deductions s DB 65

$450,000 + $0 – $12,150 = $437,850

In April 2023, Junior sells the building to AJ Holdings for $800,000.

Junior will need to calculate the amount of depreciation recovery income on the sale of the building. The amount will be the lesser of:

- The difference between the ATV of the building and the sale price, and
- The amount of depreciation loss claimed or available to be claimed in respect of the building.

When Junior calculates the amount of any depreciation recovery income it will need to remember that the ATV was reduced at the beginning of the 2021 income year by the amount of deductions taken under s DB 65. As this amount is not clawed back as depreciation recovery income, the amount of $12,150 should be added to the ATV and then the calculation undertaken. Similarly, the amount of $12,150 will not be included in the amount of "depreciation loss".

Grandparented structures

137. This category of non-residential buildings was created in response to the Commissioner's draft of IS 10/02, which was issued in 2009 for public consultation.

138. IS 10/02 included a number of examples in which the characteristics of a conventional building were applied to several structures. All of these were found to be a "building" using the ordinary meaning of the term. None of these items had been treated as a "building" before the publication of IS 10/02.

139. In July 2009, the Minister of Revenue announced that the Government would introduce legislation to ensure that the tax treatment of these structures would continue for the current owner so long as they remained in the same hands. He also stated that any new expenditure relating to improvements to the building would not be covered by the legislative change.

140. The changes that were introduced in 2010 were to:

- create a category of buildings called "grandparented structures"
- add a definition of "building" which excluded "grandparented structures"
- require improvements to a grandparented structure to be treated as a separate item of depreciable property (s EE 37(3B)).

141. A "grandparented structure" was defined in s YA 1 as:

> **grandparented structure** means, for a person, any item on the following list, if the person acquired the item, or entered into a binding contract for the purchase or construction of the item, on or before 30 July 2009:
>
> (a) barns, including barns (drying):
>
> (b) carparks (buildings):
>
> (c) chemical works:
>
> (d) fertiliser works:
>
> (e) powder drying buildings:
>
> (f) site huts

142. The definition of building introduced at that time was:

> **building,** in sub-parts EE and EZ, does not include a grandparented structure

143. The definitions of "grandparented structure" and "building" and s EE 37(3B) were repealed from the beginning of the 2021 income year. However, s EZ 23BD, which was introduced in 2022[47] and takes effect from the 2020-21 income year, allows owners of grandparented structures to claim deductions for losses on disposal. The provision brings back the definition of "grandparented structure" for this purpose.

> **EZ 23BD Loss on disposal of grandparented structure**
>
> (3) Despite section EE 48(3), subsection (2) of that section applies if the item is a grandparented structure.
>
> (4) In this section, grandparented structure means, for a person, any item on the following list, if the person acquired the item, or entered into a binding contract for the purchase or construction of the item, on or before 30 July 2009:
>
> (a) barns, including barns (drying):
>
> (b) carparks (buildings):
>
> (c) chemical works:
>
> (d) fertiliser works:
>
> (e) powder drying buildings:
>
> (f) site huts.

Further examples

144. The following examples demonstrate how the rules will likely apply in different scenarios.

Example 5 – Determining opening value

Daisy Hydroponics Ltd, that has a standard balance date of 31 March, bought a commercial building in July 2020 for $875,000 (plus GST) for use in carrying on a business of hydroponic horticultural supplies. The land was valued at $375,000 with improvements (building, building fit-out and chattels) of $500,000. The building value was $350,000 and this is the opening value for calculating depreciation on the building. The depreciation rate for a non-residential building will be the most appropriate rate for the building. Daisy will be able to choose either 2% DV or 1.5% SL.

[47] Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022, s 101.

Example 6 – Mixed-use commercial building

Portlea Limited has owned a four-storey commercial building since 2015. It has used the building for ground and first floor retail and for office and storage on the top two floors. Portlea has decided to convert the top floor into a penthouse apartment, which it will lease out for residential purposes. It also intends to reconfigure the ground and first floor into more upmarket office space. This will involve moving some non-load bearing partition walls and upgrading the lighting and heating systems. The ground floor lobby has a lift to the upper floors.

Portlea considers that a floor area test is appropriate to determine the predominant use of this building. The lobby area and lift will be available to both the residential and non-residential tenants. From the measurement of the floor area of the building, Portlea calculates that the penthouse apartment, together with a 25% share of the common area, will be 27% of the total floor area. On this basis the building is not a place used predominantly as a place of residence or abode and is therefore not a dwelling or a residential building. The building's main use is as a non-residential building. The penthouse apartment is a "dwelling" within the commercial building.

The whole building will be depreciable at the "Building (non-residential)" rate of 2% DV or 1.5% SL.

The non-structural improvements and fit-out of the offices and of any shared space, such as the lobby, will be depreciable commercial fit-out and plant. This is because commercial fit-out is either plant or non-structural items of depreciable property in a commercial building. A commercial building is one that is not a dwelling, or that includes a secondary and minor use as a dwelling. The penthouse apartment is a "dwelling" within the commercial building but based on the floor area of each, it is a secondary use.

The improvements and fit-out of the apartment will be non-depreciable. This is because the definition of "commercial fit-out" excludes plant used inside a dwelling within a commercial building and non-structural items that are used in or are part of a dwelling within a commercial building.

Example 7 – Mixed-use building with vacant commercial space

Delta Grove Holdings owns a building with four small studio apartments on the upper floor (total 100m^2) and a ground floor comprising an empty factory and office space totalling 350m^2. The ground floor is largely a shell with very little fit-out in place.

The ground floor had been leased to the previous tenant for 5 years until they vacated it 3 months ago. The bathroom facilities need replacing and the whole floor needs refurbishment and fit-out for a new tenant. Delta has not carried out this work as this would be negotiated with any new tenant.

The apartments have been leased and the ground floor is advertised as available for immediate occupation. There has been some interest in the ground floor, but no suitable tenants have been found. Delta is keen to hold out for better lease terms than those offered to date.

Delta wants to know whether the building can be classified as a 'non-residential building'.

A non-residential building is a building that is not a residential building. A residential building is one that is a dwelling, and for the purposes of the residential building definition, a dwelling is a place used *predominantly* as a place of residence or abode. Although the building contains residential dwellings on the upper floor this has been a secondary and minor use of the building. The building's predominant or main use has been for non-residential purposes. That availability for use is continuing while the owner is advertising the ground floor tenancy. The building will therefore be a non-residential building. However, as noted at [91], availability for use is a factual test that needs to be considered each year.

Example 8 – Partial change of use – commercial fit-out

Cityville Limited owns a four-storey commercial building. It decides to give the building a much-needed refurbishment with the intention of letting the building under a single lease as commercial offices. Each floor of the building has a new kitchenette fitted and upgraded toilet and shower facilities. These items have been depreciated separately from the building since acquisition as commercial fit-out. The refurbishment is finished in early 2021 and advertised for lease. A lease is negotiated but the new tenant does not want the top floor.

Cityville advertises the top floor for lease as a "loft" apartment under a residential lease.

The building's main use is as a commercial building. From the date that Cityville makes the top floor available for a residential lease, the top-floor apartment would be used or available for use as a "dwelling" within the commercial building.

The building will be depreciable at the "Building (non-residential)" rate of 2% DV or 1.5% SL. The improvements and fit-out of the commercial tenancies will be depreciable commercial fit-out and plant.

The change of use of the top floor means that Cityville will need to adjust the depreciation of the commercial fit-out to the extent that it is used in relation to, or part of, a dwelling within the commercial building.

This change of use from "commercial fit-out" to fit-out of a dwelling is an event under s EE 47(2) and the event is treated as occurring on the first day of the next income year. The effect of this event is that depreciation recovery income or additional depreciation loss could arise. Cityville must determine whether the consideration received for the s EE 47(2) event is more than the item's ATV. For this purpose, Cityville is treated as receiving consideration equal to the item's market value (s EE 45(5)).

Cityville should maintain a separate schedule of fit-out that is used for the residential tenancy from that date.

The use of the fit-out in the common areas is not changed by the commencement of a residential tenancy. In addition, the event does not trigger a change to the depreciation of the building as the building is still predominantly used for commercial purposes.

Example 9 – Residential house with separate short-term accommodation

Keith buys a property in central Otago. The land has the main house that Keith lives in with his wife. At the rear of the property is a separate building with two bedrooms and an adjoining shared ablutions block with basic cooking facilities. He also has space for a couple of tents.

Keith advertises these forms of accommodation locally on the supermarket notice board and with some local horticultural businesses. He gets backpackers, temporary workers and budget holidaymakers. He lets the bedrooms out separately but those staying must share the cooking and bathroom facilities. How long he lets the rooms varies, but it is generally less than 2 weeks. Keith prefers to let short term.

The definition of a residential building includes a building used for short-stay accommodation if there are less than 4 units for separate accommodation on the same land. In Keith's case there are two buildings on the same land:

- the building that is rented out, containing two units that can be separately occupied, and
- Keith's own home, which is not part of the rental activity.

This means the building that is rented out is a residential building, and Keith will be unable to claim depreciation deductions for that building.

Example 10 – Farm cottages and separate workers' accommodation block.

Oliver and Mary have a large sheep farm in Southland. They have three cottages on their land. Cottages A and B are permanently occupied by their farmworkers and their families. Cottage C is in the back country of the farm and used from time to time if additional workers are needed. Accommodation in Cottage C is usually for a short term.

Oliver wants to know whether he can claim depreciation deductions for the cottages. All the buildings are used, or available for use, for deriving income or in carrying on a business for that purpose. They are therefore depreciable property.

A depreciation rate of more than 0% is available only if the buildings are non-residential buildings. A building will be a residential building if it is a dwelling. A dwelling is any place "used predominantly as a place of residence or abode".

Cottages A and B are used predominantly as a place of residence for the two workers and their families; therefore, they are residential buildings.

Although Cottage C is used irregularly and for short term periods, it is then used as a residence. Therefore, Cottage C is also a dwelling and a residential building. This means depreciation deductions will not be available for any of the cottages. Items of fit-out of the buildings will not be depreciable.

Depreciation – schedule of key provisions

DA 1	General permission: allows a deduction for depreciation loss if incurred in deriving income or in carrying on a business for that purpose
Subpart EE: quantifies the amount of depreciation loss or depreciation recovery income and identifies when the deduction is allowed, or the income is derived	
EE 1(2)	When depreciation loss arises for depreciable property – sets out the requirement that the item must be used or available for use by the person in the income year
EE 1(3)	When depreciation recovery income arises
EE 2 – EE 5	The meaning of "owns" depreciable property
EE 6	What is depreciable property
EE 7	What is **not** depreciable property
EE 8	Election that property is not depreciable
EE 9	Identifies the provisions that need to be considered for the elements of the depreciation calculation: • methods and calculation (EE 12- EE 24) • rates (EE 26 -EE 36) • improvements (EE 37) • transfers (EE 40 – EE 43) • disposals and similar events (EE 44- 52) • interpretation provisions (EE 54- EE 67)
EE 12	Depreciation methods – straight line, diminishing value and pool methods – a building cannot be poolable property (EE 66(2))
EE 14-16	Calculation of the amount of depreciation – the elements of the formula
EE 28	Setting the economic depreciation rate for buildings
EE 31	Sets the annual rate for a **residential building** with an EUL of 50 years or more at 0%
EE 35 – EE 36	Special and provisional rates
EE 37	Improvements: how to treat improvements in the year made and following years
EE 40	Transfer of property between associated persons
EE 44	Disposal of depreciable property – and events treated as disposals
EE 45	Consideration on disposal

EE 47	Disposal events – including change of use, irreparable damage to a building, statutory acquisition
EE 48	Effect of the disposal or event – calculating the depreciation recovery income or additional depreciation loss
EE 54	Cost – adjusted for GST
EE 55-60	Adjusted tax value (ATV): formula (EE 56), base value (EE 57 – EE 58), deductions (EE 60)
EE 61	Meaning of annual rate – annual rate for residential buildings set at 0% (EE 61(3B), EE 61(7B))
YA 1	Definitions: commercial building, commercial fit-out, dwelling, independent living, non- residential building, plant, residential building.

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Melfort Danceland v Star City (Rural Municipality) [1977] 3 WWR 737

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R v Swansea City Council ex p Elitestone Ltd (1993) 66 P & CR 422

Stevens v Gourley (1859) 7 CBNS 99

Spencer v Soljan (1984) 10 NZTPA 289

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IS 22/05: Cash basis persons under the financial arrangements rules

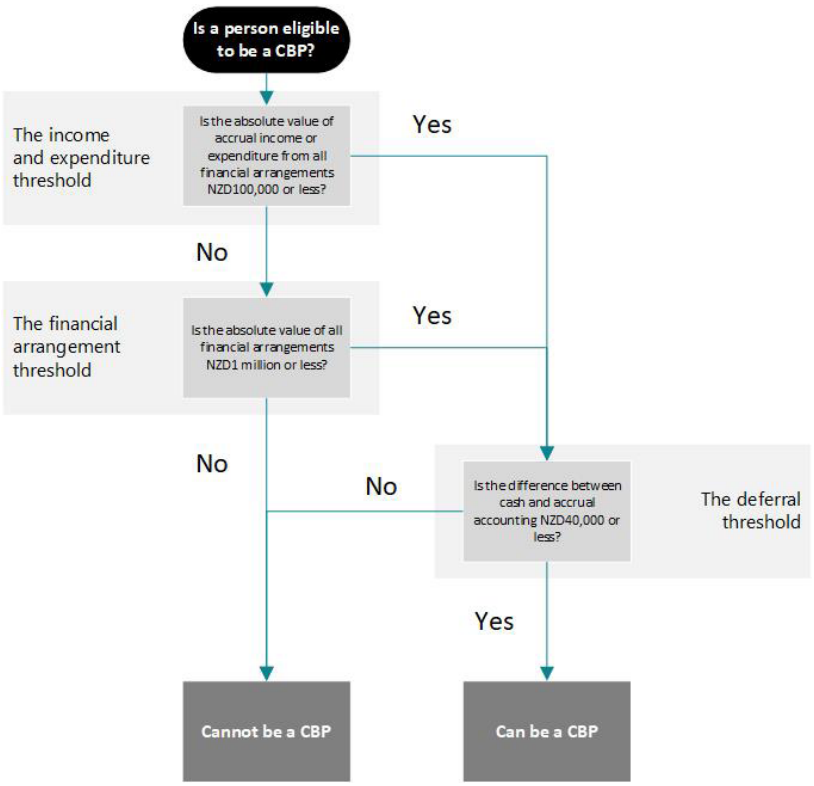
All legislative references are to the Income Tax Act 2007 unless otherwise stated.

Summary

1. This interpretation statement answers a specific question that arose from IS 20/07 *Income tax – Application of the financial arrangements rules to foreign currency loans used to finance foreign residential rental property*.[1] While IS 20/07 explains who qualifies as a cash basis person (CBP), at [39] it states that the details of the cash basis adjustment (CBA) calculation are beyond its scope. This statement revisits the meaning of CBP. It also covers how to perform a CBA and provides worked examples.
2. Under the financial arrangements rules (FA rules), a CBP[2] can account for income when it is received and for expenditure when it is paid during the life of an arrangement. This approach is simpler than accounting for income and expenditure from a financial arrangement on an accrual basis. However, like a person on the accrual basis, at the end of the arrangement a CBP must do a wash-up calculation called a base price adjustment (BPA). IS 20/07 deals with BPAs in detail.
3. To be a CBP, a person must not hold financial arrangements that exceed the following thresholds:
   - NZD100,000 for the income and expenditure threshold (s EW 57(1)); or
   - NZD1 million for the financial arrangement threshold[3] (s EW 57(2));

   and
   - NZD40,000 for the deferral threshold (s EW 57(3)).
4. If **both** the income and expenditure and financial arrangement thresholds are exceeded, a person cannot be a CBP. If **neither** threshold **or only one** is exceeded, whether a person can be a CBP depends on whether the deferral threshold is exceeded. This is summarised in Figure 1 – Is a person eligible to be a CBP?.

Figure 1 – Is a person eligible to be a CBP?



[1] *Tax Information Bulletin* Vol 32, No 7 (August 2020): 110.

[2] The Commissioner may treat a CBP as not being a CBP for a class of financial arrangements if there has been structuring and promotion of the class to defer a tax liability. This also may apply where the parties to a financial arrangement are associated and calculate different amounts of income and expenditure: s EW 59.

[3] This is referred to as the absolute value threshold in the legislation.

5. Determining whether the first two thresholds are exceeded involves adding the absolute values of income and expenditure from financial arrangements for the income and expenditure threshold and the absolute values of those arrangements for the financial arrangement threshold. Absolute values ignore whether an amount is positive or negative.
6. A CBP needs to review their compliance with the thresholds annually. Some financial arrangements are known as excepted financial arrangements (EFAs) and are not counted.
7. Whether a person has exceeded the deferral threshold is not something one can always tell at a glance. Where the financial arrangement is cross-border, for example, fluctuations in the New Zealand dollar against a foreign currency can cause the deferral threshold to be exceeded. If this occurs and the person is a CBP, they will usually have to perform a CBA.
8. This statement applies to New Zealand tax residents, both natural persons and entities, with financial arrangements who may be eligible to account for income and expenditure as a CBP. The FA rules generally do not apply to non-residents, but there are exceptions[4].
9. New Zealand residents who are transitional residents are not subject to the FA rules until their transitional residency ends. This applies if no other party to the arrangement is a New Zealand resident and the arrangement is not for the purpose of a business carried on in New Zealand[5]. The values a transitional resident must use on entering the FA rules are not addressed in this statement. Financial arrangements of transitional residents are covered from paragraph 9 in IS 20/07.

Introduction

10. This interpretation statement explains when a person can account for income and expenditure from financial arrangements on a cash basis instead of an accrual basis. It also sets out the adjustment that must usually be made when a person ceases to be a CBP and must account for their financial arrangements using the accrual basis.

The financial arrangements rules

11. Generally, a financial arrangement occurs when money is received now in consideration for money to be paid later (such as with a loan), unless specifically excluded by the Act.[6] The tax treatment of financial arrangements is governed by the FA rules.
12. The FA rules essentially require parties to a financial arrangement to spread income or expenditure from the arrangement over its term. The key purposes of the rules are to prevent deductions for expenditure being accelerated and income recognition being deferred.
13. This statement builds on IS 20/07. IS 20/07 is related to IS 20/06: *Income tax – Tax issues arising from owning foreign residential rental property*[7] and FX 20/01: *Approval – foreign residential rental property amounts – currency conversion*.[8]
14. IS 20/07 considered how the FA rules apply to foreign currency loans used to finance foreign residential rental properties. In doing so, IS 20/07 covered several topics including:
    - the scope of the FA rules;
    - EFAs;
    - CBPs and non-CBPs;
    - income under the FA rules; and
    - expenditure under the FA rules.
15. Although IS 20/07 explains who qualifies as a CBP, at [39] it states that the details of the CBA calculation are beyond its scope. This statement explains, with examples:
    - the requirements to be a CBP; and
    - how to perform a CBA.

[4] Sections EW 9(3) and EW 9(4).
[5] Section EW 5(17).
[6] Section EW 3.
[7] *Tax Information Bulletin* Vol 32, No 7 (August 2020): 98.
[8] *Tax Information Bulletin* Vol 32, No 7 (August 2020): 28.

Requirements to be a cash basis person

16. Before working through the requirements to be a CBP, it is useful to understand the effect of being a CBP.

Effect of being a cash basis person

17. Income and expenditure from a financial arrangement must be accounted for on an accrual basis during the life of the arrangement unless the person is a CBP. A CBP accounts for income when it is received and for expenditure when it is paid. A CBP is not required to apply any of the spreading methods to their financial arrangements, unless they choose to do so.[9] This approach is simpler than accounting for financial arrangements on the accrual basis and may reduce compliance costs.
18. A person using the accrual basis spreads income and expenditure over the term of the arrangement, regardless of when it has actually been received or paid. The accrual basis sometimes requires complex calculations to determine the amounts of income and expenditure allocated to each year. In this statement, the term "non-CBP" refers to a person who accounts for their financial arrangements on the accrual basis.
19. Both a CBP and non-CBP must usually calculate a BPA.[10] A BPA must usually be performed when a financial arrangement matures or ends – for example, a loan is repaid, or the person ceases to be a New Zealand tax resident.[11] A BPA is different from a CBA. A CBA is performed when a person's status changes from CBP to non-CBP, or vice versa. It is also performed when a CBP elects to use a spreading method.

The four steps to determining cash basis person status

20. Determining whether a person is a CBP involves working through various requirements in the legislation. A person's status should be reviewed annually. If a person ceases to qualify as a CBP, they usually need to make a CBA.
21. The four steps are outlined in Figure 2 – The four steps.

Figure 2 – The four steps

Step 1	Determine all financial arrangements held.
Step 2	Exclude all excepted financial arrangements.
Step 3	Consider whether the NZD100,000 income and expenditure threshold or the NZD1 million financial arrangement threshold applies.
Step 4	If one of the thresholds in Step 3 applies, consider the NZD40,000 deferral threshold.

[9] Section EW 55(1) and see from [66] to [69].

[10] The BPA is covered in IS 20/07, from [51] to [64]. The formula for the BPA is in s EW 31.

[11] Section EW 29(1).

Step 1: Determine all financial arrangements held

22. The first step is to identify all the financial arrangements a person holds. Generally, a financial arrangement occurs when money is received now in consideration for money to be paid later (such as with a loan), unless the Act specifically excludes it.[12] The tax treatment of financial arrangements is governed by the FA rules.

23. IS 20/07 specifically considered a foreign currency loan that had been taken out to finance a foreign residential rental property. Foreign currency loans are "debt", which s EW 3(3)(a) uses as an example of a financial arrangement. A home loan in New Zealand dollars is also a financial arrangement and needs to be included in determining whether the thresholds have been exceeded even though no income or expenditure is likely to arise. Other examples of financial arrangements are term deposits and foreign currency bank accounts.

Step 2: Excepted financial arrangements

24. Section EW 4(3) provides that EFAs are not financial arrangements for the purposes of the FA rules. This means there is no need to use a spreading method or perform a BPA when the arrangement ends. Section EW 5 lists the types of financial arrangements that are EFAs.

25. Explaining the full range of EFAs is beyond the scope of this statement and each person needs to consider their own circumstances. However, four common arrangements that may be EFAs are:

- variable principal debt instruments (VPDIs);
- foreign currency loans for private or domestic purposes for CBPs;
- loans in New Zealand dollars that are interest-free and repayable on demand for the lender; and
- shares.

Variable principal debt instruments

26. A VPDI is defined in s YA 1 as:

> **variable principal debt instrument,—**
>
> (a) in the financial arrangements rules, means a financial arrangement that contemplates that 1 party may, on demand or call,—
>
> (i) advance further amounts to the other party; or
>
> (ii) require the return of all amounts advanced to the other party, if the other party's rights and obligations under the financial arrangement are expressed in a foreign currency:
>
> (b) in the old financial arrangements rules, is defined in section EZ 48 (Definitions)

27. A VPDI is an EFA if the total value on every day in an income year of all VPDIs to which the person is a party is NZD50,000 or less.[13] *Example 1* illustrates one situation.

Example 1: VPDI that is an excepted financial arrangement

Manaia's only VPDI is his New Zealand credit card account with a limit of NZD10,000. This is an EFA because on every day of the income year the total value of the account is below NZD50,000.

28. VPDIs are also considered further from [44] of this statement and at [19] to [21] of IS 20/07.

29. If the VPDI in the example was a bank account earning interest, the person would need to account for the income on a cash basis but would not need to do a BPA when the account was closed.

Foreign loans for private or domestic purposes for cash basis persons

30. A loan in a foreign currency used for a private or domestic purpose is an EFA for CBPs.[14] An example is a loan denominated in Australian dollars (AUD) from an Australian bank[15] to finance a holiday home on the Gold Coast that is used exclusively for private or domestic purposes.

[12] Section EW 3.

[13] Section EW 5(25).

[14] Section EW 5(18).

[15] IS 20/06 explains at paragraph 78 that there may be an obligation to deduct non-resident withholding tax.

31. Note that the loan must be included in the calculations to determine whether a person is a CBP. The loan will not be an EFA if the person is not a CBP. The loan will also not be an EFA if circumstances change and the foreign property becomes a rental property.

Interest-free repayable on demand loans in New Zealand dollars

32. A loan in New Zealand dollars which is interest-free and repayable on demand is an EFA for the lender. These loans are commonly used in trust arrangements.

33. The loan is not an EFA for the borrower and must be included in the threshold calculations.

Shares

34. A share is generally an EFA.[16] However, money borrowed to buy shares is likely to be a financial arrangement.[17]

Summary

35. When considering the different thresholds, it is important to determine what is a financial arrangement and what is an EFA. *Example 2* illustrates what Jemima needs to consider when she reviews her portfolio of financial assets and liabilities before she can determine whether she is eligible to be a CBP.

Example 2: Examples of financial arrangements and excepted financial arrangements

Before determining whether she qualifies as a CBP, Jemima lists her financial assets and liabilities and determines which are financial arrangements.

- Jemima has a loan from a bank in the United Kingdom in British pounds (GBP) that finances a rental property she owns in the UK – financial arrangement.
- Jemima has a loan from an Australian bank in AUD that finances a holiday home she owns on the Gold Coast and only uses for her private purposes – financial arrangement (it becomes an EFA if Jemima satisfies the criteria to be a CBP).
- Jemima has a home loan from a New Zealand bank to finance her New Zealand residence – financial arrangement.
- Jemima owns a share portfolio[18] – EFA.
- Jemima took out a loan from a New Zealand bank that she used to buy the share portfolio – financial arrangement.
- Jemima recently inherited a New Zealand government bond from her aunt's estate – financial arrangement.

Jemima needs to consider her financial arrangements for the purpose of the threshold calculations.

Step 3: The income and expenditure and financial arrangement thresholds

36. A CBP is defined in s YA 1 by referring to the definition in s EW 54. A person can be a CBP[19] if, for the income year, they do not exceed the deferral threshold in Step 4 and either:
    - the NZD100,000 income and expenditure threshold (s EW 57(1)); or
    - the NZD1 million financial arrangement threshold (s EW 57(2)).

[16] Section EW 5(13).

[17] Section EW 3(2).

[18] Shares in foreign companies may be subject to the foreign investment fund rules. See IR461 *Guide to foreign investment funds*.

[19] The trustee of an estate is a CBP for financial arrangements in the estate if, at the date of death, the deceased was a CBP and the financial arrangements in the estate meet the requirements of s EW 54. This status lasts for 5 income years unless the requirements are no longer met: s EW 60.

37. Sections EW 57(1) and EW 57(2) state:

> **EW 57 Thresholds**
>
> *Income and expenditure threshold*
>
> (2) For the purposes of section EW 54(1)(a)(i), this subsection applies if the absolute value of the person's income and expenditure in the income year under all financial arrangements to which the person is a party is $100,000 or less.
>
> *Absolute value threshold*
>
> (3) For the purposes of section EW 54(1)(a)(ii), this subsection applies if, on every day in the income year, the absolute value of all financial arrangements to which the person is a party added together is $1,000,000 or less. The value of each arrangement is,—
>
> (a) for a fixed principal financial arrangement, its face value:
>
> (b) for a variable principal debt instrument, the amount owing by or to the person under the financial arrangement:
>
> (c) for a financial arrangement to which the old financial arrangements rules apply, the value determined under those rules.

38. To satisfy Step 3, the person must not exceed the income and expenditure threshold or the financial arrangement threshold. This requires:
    - the absolute value of income and expenditure calculated on an accrual basis for the income year under all financial arrangements held by the person does not exceed NZD100,000; or
    - on every day in the income year, the total absolute value of all financial arrangements held by the person does not exceed NZD1 million.

39. If both thresholds are exceeded, the person is not a CBP in that year and will have to use a spreading method. If the person is under one of the thresholds, they need to consider the deferral threshold in Step 4 before they can determine whether they are a CBP.

Absolute value

40. The term "absolute value" is defined in s YA 1 as "the value irrespective of whether the value's sign is positive or negative". This means that income under one financial arrangement is not offset by expenditure under another financial arrangement. Rather, the two amounts are added together as though they were both positive numbers. Similarly, the values of financial arrangements are added together in absolute terms regardless of whether they are assets or liabilities.

The income and expenditure threshold

41. *Example 3* shows how the income and expenditure threshold applies when a person has both income and expenditure from their financial arrangements.

Example 3: Income and expenditure threshold

Wei is a New Zealand resident and has a rental property on the Gold Coast that he financed with an AUD500,000 loan from an Australian bank. Wei has also made a loan of NZD60,000 to Jake. Wei needs to consider both loans to determine whether he is eligible to be a CBP.

Income and expenditure threshold

Wei notes that the amount of annual interest expenditure on the Australian loan converted to NZD at the appropriate rate is NZD30,000. Wei also notes that the annual interest income from the loan to Jake is NZD5,000. Both amounts are calculated on an accrual basis. In adding the absolute values of these amounts, Wei must ignore the fact that one of them is expenditure and the other is income. The absolute values of these amounts total NZD35,000, which is under the NZD100,000 income and expenditure threshold.

Having satisfied the income and expenditure threshold, there is no reason for Wei to consider the financial arrangement threshold because he only needs to satisfy one of the thresholds in Step 3 before considering the deferral threshold in Step 4.

The financial arrangement threshold

42. Under s EW 57(2), the value of each arrangement on any day is:
    - for a fixed principal financial arrangement, its face value;
    - for a VPDI, the amount owing by or to the person under the financial arrangement; or
    - for a financial arrangement to which the old financial arrangements rules[20] apply, the value determined under those rules.

Fixed principal financial arrangement

43. A "fixed principal financial arrangement" is defined in s YA 1 as a financial arrangement other than a VPDI. An example of a fixed principal financial arrangement would be a fixed sum loan repayable at the end of the agreed term.

Variable principal debt instrument

44. As noted at [26], VPDIs are financial arrangements that may need to be accounted for under the FA rules if they exceed the NZD50,000 threshold on any day in the year. An example of a VPDI is a revolving credit facility where the borrower can borrow or repay principal at any time. Other examples are credit card accounts and everyday bank accounts.

Financial arrangements to which the old financial arrangements rules apply

45. Section EZ 33 provides that the old FA rules apply for financial arrangements entered into before 20 May 1999. The old FA rules are essentially contained in ss EZ 33 to EZ 52D. The provisions are essentially the same in terms of characterising financial arrangements as fixed principal financial arrangements or VPDIs and valuing the financial arrangements. Therefore, this statement focuses on the current FA rules.

Threshold satisfied on every day of the income year

46. The financial arrangement threshold cannot be exceeded on **any day** of the income year. At first, it may seem onerous to consider every day in the year, but it can be relatively easy to determine whether the threshold has been exceeded, especially if there is only one financial arrangement. For fixed principal financial arrangements, the daily outstanding balance needs to be considered. Generally, the balance at the start of a period will be the relevant amount because it would be expected to decline as repayments of principal and interest are made. Therefore, if this is the only financial arrangement and the total is under the threshold at the start of the period, it is likely to be under the threshold for the whole year.
47. An exception to this general approach occurs when the financial arrangement is in a foreign currency and subject to exchange rate fluctuations. In these cases, identifying when the New Zealand dollar is at its lowest point compared with the foreign currency and calculating the value at that time is likely to give the highest value of the financial arrangement if the principal has not changed materially.
48. For VPDIs, the amount owing each day needs to be considered. Where the VDPI has a limit, such as an overdraft or credit card, it will simplify the calculations if the limit is used rather than the daily balance unless the threshold is close to being breached.
49. *Example 4* illustrates the approach to applying the financial arrangement threshold.

Example 4: Financial arrangement threshold

Carrying on from *Example 3: Income and expenditure threshold*, Wei does not need to consider the financial arrangement threshold to be eligible to be a CBP because he was under the income and expenditure threshold. However, this example will consider the financial arrangement threshold to illustrate how it might be applied.

As noted, Wei has a rental property on the Gold Coast that he financed with a loan of AUD500,000 from an Australian bank. Wei has also made a loan of NZD60,000 to Jake.

Wei notes that loan with the Australian bank is a fixed principal financial arrangement, meaning that the value is determined by its face value each day. However, as it is denominated in AUD, the exchange rate also needs to be factored in. For the 2021 income year, Wei notes that the NZD/AUD exchange rates for 1 April 2020 and 31 March 2021 were as follows:

Date	NZD/AUD rate	Loan value
1 April 2020	0.9710	NZD514,933.06
31 March 2021	0.9182	NZD544,543.67

[20] See from [45].

Wei also notes that on 18 August 2020 the NZD/AUD rate was 0.9062. This was the lowest value for the year. Therefore, on this date the loan value peaked at NZD551,754.58 (assuming that the principal value of the loan did not decrease over the course of the year).

The loan to Jake is also a fixed principal financial arrangement, meaning that its value is determined by its face value each day. As it is denominated in NZD, its value is NZD60,000 (once again, assuming that the principal value of the loan did not decrease over the course of the year).

In adding the absolute values of these amounts, Wei has to ignore the fact that one of them is a liability and the other is an asset to him. The absolute values of the highest amounts for the year are NZD551,754.58 plus NZD60,000 equals NZD611,754.58. This is under the NZD1 million financial arrangement threshold.

Therefore, Wei is under both the income and expenditure and financial arrangement thresholds. He only needs to be under one of the thresholds to move to Step 4, which is the deferral threshold.

Step 4: The deferral threshold

50. To determine whether a person can be a CBP, Step 4 involves checking whether their financial arrangements are under the deferral threshold. The deferral threshold is set out in s EW 57:

Deferral threshold

(3) For the purposes of section EW 54(1)(b), this subsection applies if the result of applying the formula in subsection (4) to each financial arrangement to which the person is a party at the end of the income year and adding the outcomes together is $40,000 or less.

Formula

(4) The formula is—

(accrual income − cash basis income) + (cash basis expenditure − accrual expenditure).

Definition of items in formula

(5) The items in the formula are defined in subsections (6) to (9).

Accrual income

(6) **Accrual income** is the amount that would have been income derived by the person under the financial arrangement if the person had been required to use a spreading method in the period starting on the date on which they became a party to the arrangement and ending on the last day of the income year for which the calculation is made. It is calculated using 1 of the following methods, as chosen by the person:

(a) the yield to maturity method, whether or not the person may use it, or has chosen to use it, for their financial arrangement; or

(b) the straight-line method, whether or not the person may use it, or has chosen to use it, for their financial arrangement; or

(c) an alternative method approved by the Commissioner.

Cash basis income

(7) **Cash basis income** is the amount that would have been income derived by the person under the financial arrangement if the person had been a cash basis person in the period starting on the date on which they became a party to the arrangement and ending on the last day of the income year for which the calculation is made.

Cash basis expenditure

(8) **Cash basis expenditure** is the amount that would have been expenditure incurred by the person under the financial arrangement if the person had been a cash basis person in the period starting on the date on which they became a party to the arrangement and ending on the last day of the income year for which the calculation is made.

Accrual expenditure

(9) **Accrual expenditure** is the amount that would have been expenditure incurred under the financial arrangement if the person had been required to use a spreading method in the period starting on the date on which they became a party to the arrangement and ending on the last day of the income year for which the calculation is made. It is calculated using 1 of the following methods, as chosen by the person:

(a) the yield to maturity method, whether or not the person may use it, or has chosen to use it, for their financial arrangement; or

(b) the straight-line method, whether or not the person may use it, or has chosen to use it, for their financial arrangement; or

(c) an alternative method approved by the Commissioner.

51. Determining whether the deferral threshold has been breached requires comparison of income and expenditure calculated on a cash basis and an accrual basis. A person is a CBP if the result of applying the formula does not exceed NZD40,000. If the result is greater than NZD40,000, the person cannot be a CBP. If a person was a CBP in the previous year, they must usually calculate a CBA and use a spreading method until they qualify again.

52. Income and expenditure are calculated from when the person became party to the financial arrangement up to the end of the income year for which the calculation is made. The effect of this is to determine the difference between accounting for the financial arrangement on a cash versus accrual basis over the period for which the person has been party to the financial arrangement. It means, for example, that if the person acquired the financial arrangement in Year 1, then to do the calculation for Year 2, the person must combine income and expenditure from Year 1 and Year 2.

Applying the formula

53. The formula in s EW 57(4) is:

(accrual income – cash basis income) + (cash basis expenditure – accrual expenditure)

54. The formula adds the difference between the income calculated on an accrual versus cash basis to the difference between the expenditure calculated on a cash versus accrual basis. It determines whether income has been deferred or expenditure has been accelerated.

Cash basis amounts

55. Calculating the income and expenditure on a cash basis is generally straightforward. The cash basis focuses on actual cash flows under the financial arrangement. The essential step is to include all cash basis income or expenditure from the start of the financial arrangement through to the end of the income year for which the calculation is being made.

Accrual basis amounts

56. Calculating the income and expenditure on an accrual basis is generally more complicated, especially when it is necessary to convert foreign currencies to New Zealand dollars. Sections EW 57(6) and EW 57(9) state that accrual income and expenditure are calculated using one of the following methods:

- the yield to maturity method
- the straight-line method
- an alternative method approved by the Commissioner.

57. For the purposes of calculating the deferral threshold, there is concessionary treatment for using the yield to maturity and straight-line methods. Firstly, they can be used whether the person is normally permitted to use them. For example, s EW 17(1) would normally prevent the use of the straight-line method if the total value of all financial arrangements exceeded NZD1.85 million.

58. Secondly, they can also be used whether a person has chosen to use the method for their financial arrangement. For example, a person who is currently a non-CBP and using yield to maturity to calculate income and expenditure can use the straight-line method to determine if they are under the deferral threshold in the current income year.

59. The Commissioner has approved a number of alternative methods in determinations. For the purposes of *Example 5*, *Example 6* and *Example 7*, we have used *Determination G9A: Financial arrangements that are denominated in a currency or commodity other than New Zealand dollars*.[21]

[21] Inland Revenue, 1989.

60. Determination G9A applies where it is necessary to calculate income or expenditure for a financial arrangement and any right or obligation is fixed or otherwise determined in a currency or commodity other than New Zealand dollars. IS 20/07 also explains at [40] to [49] how to apply Determination G9A and provides a worked example – see [50].
61. Determination G9A follows what is known as a "mark to spot" methodology. This involves converting the New Zealand dollar equivalent amount of all the foreign currency transactions that occur over the term of the arrangement, together with the end-of-year outstanding principal balances, at the relevant spot rate.
62. For the purposes of Determination G9A, *Determination G6D: Foreign currency rates*[22] sets out relevant methods and sources of rates to use when converting foreign currency amounts into New Zealand dollars
63. For the purposes of the FA rules and Determination G9A, accrual income or expenditure is a net amount, so that the result is either income or expenditure.[23] If applying Determination G9A results in a positive figure, it represents income derived in the relevant income year. In the context of a foreign currency loan, an increase in the value of the New Zealand dollar can cause the borrower to be deemed to have derived an amount of income.
64. If applying Determination G9A results in a negative figure, it is expenditure incurred in the relevant income year. The expenditure under the FA rules may be more or less than the actual expenditure on the loan, depending on the movement of foreign exchange rates. Deductibility is discussed from [80] of this statement.

Example 5: Whether a person is a cash basis person for 2015/16

The facts of this example are carried through to Example 6: Whether a person is a cash basis person for 2016/17 and Example 7: Cash basis adjustment calculation for 2016/17. The examples illustrate the threshold calculations as well as the CBA. The financial arrangement is shown for two income years to illustrate the different treatment that can occur from year to year.

On 5 April 2015, Adam, who is a New Zealand resident, obtained a loan of GBP500,000 from a bank in the UK to finance a rental property in London. The loan was for 20 years with monthly repayments and an interest rate of 3%.

Adam received rental income from the property. Rental income is not financial arrangement income and is taxed under s CC 1.

The loan is a financial arrangement. Adam needs to determine whether he is a CBP for 2015/16.

Income and expenditure threshold

Adam calculates his income and expenditure from the loan on an accrual basis to see whether it is under the income and expenditure threshold. The results of the calculations are also used for the deferral threshold. As the loan is denominated in a foreign currency, he uses the method described in Determination G9A.

Calculate closing tax book value in British pounds

The first step is to calculate the closing tax book value of the loan in British pounds. The formula is:

$$CTBV = e + f + g + h + i$$

The variables are:

e = opening tax book value (which is always zero in the first year)

f = consideration paid by the person

g = accrual income

h = consideration paid to the person

i = accrual expenditure.

As the loan is a table mortgage, Adam chooses to use the yield to maturity method in Determination G3 to calculate income or expenditure. For amounts which fall into two income years, he uses Determination G1A to apportion them on a daily basis.

The amounts for 'e', 'g' and 'h' in the example are easily identifiable. As this is the first year of the loan, 'e' is zero. Similarly, there is no accrual income so 'g' is zero. The only consideration paid to Adam was the initial amount of the loan advanced to him so 'h' is GBP500,000. Adam needs to calculate the amounts for 'f' and 'i'.

In order to do so, he uses a template in Excel to produce the following loan amortisation schedule that shows each monthly loan payment, the split between principal and interest and the declining balance. All amounts are in GBP.

[22] Inland Revenue, 1991.

[23] Section EW 14(3).

Table 1: Loan payments for 2015/16 in GBP

Dates	Monthly payments	Principal	Interest	Balance
5 May 2015	2,772.99	1,522.99	1,250.00	498,477.01
5 Jun 2015	2,772.99	1,526.80	1,246.19	496,950.22
5 Jul 2015	2,772.99	1,530.61	1,242.38	495,419.60
5 Aug 2015	2,772.99	1,534.44	1,238.55	493,885.17
5 Sep 2015	2,772.99	1,538.28	1,234.71	492,346.89
5 Oct 2015	2,772.99	1,542.12	1,230.87	490,804.77
5 Nov 2015	2,772.99	1,545.98	1,227.01	489,258.79
5 Dec 2015	2,772.99	1,549.84	1,223.15	487,708.95
5 Jan 2016	2,772.99	1,553.72	1,219.27	486,155.24
5 Feb 2016	2,772.99	1,557.60	1,215.39	484,597.64
5 Mar 2016	2,772.99	1,561.49	1,211.49	483,036.14
Total to 31 March	30,502.87	16,963.86	13,539.01	
5 Apr 2016	2,772.99	1,565.40	1,207.59	481,470.75

The figure for 'f' is GBP30,502.87, being the total of the monthly payments during the year to 31 March (shown in Table 1).

The figure for 'i' is GBP14,551.83. This is the total interest to 31 March of GBP13,539.01 plus the portion of interest paid on 5 April 2016 that relates to the 2015/16 year. This amount is GBP1,207.59 divided by 31 days times 26 days, or GBP1,012.82.

The CTBV is then negative GBP484,048.96 as follows:

$$CTBV = e + f + g + h + i$$

$$CTBV = 0 + 30{,}502 + 0 - 500{,}000 - 14{,}551.83$$

$$CTBV = -\text{GBP}484{,}048.96$$

Calculate income or expenditure in New Zealand dollars

The next step is to calculate the income or expenditure in 2015/16 in New Zealand dollars. The formula is:

$$\textit{accural income or expenditure} = a + b - c - d$$

The variables are:

a = closing tax book value

b = consideration paid to the person

c = opening tax book value (always zero in the first year)

d = consideration paid by the person

Adam obtains the spot rates for the conversions below from a registered bank.

The figure for 'a' is the closing tax book value of negative GBP484,048.96 divided by 0.4812, which was the exchange rate on 31 March 2016. The result is negative NZD1,005,920.53.

The figure for 'b' is the loan of GBP500,000 divided by 0.5065, which was the exchange rate on 5 April 2015. The result is NZD987,166.83.

The figure for 'c' is zero as there was no opening balance.

The figure for 'd' is NZD68,393.90. This is the total of the monthly payments in British pounds converted into New Zealand dollars as shown in Table 2. Table 2 also shows interest converted into New Zealand dollars. Adam uses the total later in the deferral threshold calculation.

Table 2: Loan payments for 2015/16 converted to NZD

Dates	Monthly payments GBP	Interest GBP	Exchange rates	Monthly payments NZD	Monthly interest NZD
5 May 2015	2,772.99	1,250.00	0.4984	5,563.78	2,508.03
5 Jun 2015	2,772.99	1,246.19	0.4645	5,969.83	2,682.87
5 Jul 2015	2,772.99	1,242.38	0.4293	6,459.32	2,893.96
5 Aug 2015	2,772.99	1,238.55	0.4200	6,602.35	2,948.93
5 Sep 2015	2,772.99	1,234.71	0.4138	6,701.28	2,983.84
5 Oct 2015	2,772.99	1,230.87	0.4244	6,533.90	2,900.25
5 Nov 2015	2,772.99	1,227.01	0.4285	6,471.38	2,863.51
5 Dec 2015	2,772.99	1,223.15	0.4447	6,235.64	2,750.50
5 Jan 2016	2,772.99	1,219.27	0.4587	6,045.32	2,658.10
5 Feb 2016	2,772.99	1,215.39	0.4615	6,008.64	2,633.56
5 Mar 2016	2,772.99	1,211.49	0.4779	5,802.44	2,535.04
Totals	30,502.87	13,539.01		68,393.90	30,358.58

Adam puts these figures into the formula as follows:

accural income or expenditure = a + b – c – d

accural income or expenditure = 1,005,920.53 + 987,166.83 – 0 – 68,393.90

accural expenditure = –87,147.60

The result of applying the formula is negative NZD87,147.60. The absolute value is NZD87,147.60. As this is under the income and expenditure threshold of NZD100,000, Adam can consider the deferral threshold in Step 4.

Financial arrangement threshold

Because Adam is under the income and expenditure threshold, he does not need to consider this threshold. However, if he did, he would notice that when he drew the loan down on 5 April 2015, the value in New Zealand dollars was NZD987,166.83. This was close to exceeding the financial arrangement threshold of NZD1 million. He would also notice that the New Zealand dollar depreciated during the year. The effect of this is to increase the value of the loan.

For example, on 5 May 2015 the exchange rate was 0.4984. Table 1 shows the value of the loan in British pounds was GBP498,477.01 on this date. The value of the loan in New Zealand dollars was NZD1,000,154.51. This was above the financial arrangement threshold.

Deferral threshold for the 2015/16 income year

Adam needs to calculate his cash basis income and expenditure and his accrual income and expenditure in New Zealand dollars. He then needs to put these amounts into the formula in s EW 57(4) to determine whether he is under the deferral threshold.

Cash basis income or expenditure

Adam has no cash basis income from the financial arrangement.

Adam paid interest of NZD30,358.58 to the UK bank as shown in Table 2. This is his cash basis expenditure.

Accrual income or expenditure

Adam's accrual expenditure was NZD87,147.60 as calculated above.

The deferral threshold

The formula for the deferral threshold is:

(accrual income – cash basis income) + (cash basis expenditure – accrual expenditure)

(0 – 0) + (30,358.58 – 87,147.60) = –56,789.02

As NZD56,789.02 is a negative amount, it is below the deferral threshold of NZD40,000. Adam has not exceeded the income and expenditure and deferral thresholds. He is eligible to be CBP in 2015/16. He can deduct NZD30,358.58 as his cash basis expenditure.

65. *Example 6* shows Adam's calculations for 2016/17 income year.

Example 6: Whether a person is a cash basis person for 2016/17

Adam needs to do the same calculations in 2016/17 as in 2015/16 to see whether he is under the thresholds.

Income and expenditure threshold

Calculate closing tax book value in British pounds

The first step is to calculate the closing tax book value of the loan in British pounds. The formula as set out above is:

CTBV = e + f + g +h + i

As in 2015/16, the amounts for 'e', 'g' and 'h' in the example are easily identifiable. The opening tax book value for 2016/17 is the same as the CTBV from 2015/16. This means that 'e' is -484,048.96. Once again 'g' is zero as there is no accrual income for 2016/17. No further amounts are advanced to Adam so 'h' is zero. Adam needs to calculate the amounts for 'f' and 'i".

The loan amortisation schedule Adam created shows the following for 2016/17.

Table 3: Loan payments for 2016/17 in GBP

Dates	Monthly payments	Principal	Interest	Balance
5 Apr 2016	2,772.99	1,565.40	1,207.59	481,470.75
5 May 2016	2,772.99	1,569.31	1,203.68	479,901.43
5 Jun 2016	2,772.99	1,573.23	1,199.75	478,328.20
5 Jul 2016	2,772.99	1,577.17	1,195.82	476,751.03
5 Aug 2016	2,772.99	1,581.11	1,191.88	475,169.92
5 Sep 2016	2,772.99	1,585.06	1,187.92	473,584.86
5 Oct 2016	2,772.99	1,589.03	1,183.96	471,995.83
5 Nov 2016	2,772.99	1,593.00	1,179.99	470,402.83
5 Dec 2016	2,772.99	1,596.98	1,176.01	468,805.85
5 Jan 2017	2,772.99	1,600.97	1,172.01	467,204.88
5 Feb 2017	2,772.99	1,604.98	1,168.01	465,599.90
5 Mar 2017	2,772.99	1,608.99	1,164.00	463,990.92
Total at 31 March	**33,275.86**	**19,045.23**	**14,230.63**	
5 Apr 2017	2,772.99	1,613.01	1,159.58	462,377.91

The figure for 'f' is GBP33,275.86, being the total of the monthly payments during the year to 31 March (shown in Table 3).

The figure for 'i' is GBP14,190.70. This is the total interest to 31 March of GBP14,230.63 less GBP1,012.82 accrued in 2015/16 plus the portion of the interest paid on 5 April 2017 that relates to the 2016/17 year. This amount is GBP1,159.98 divided by 31 days times 26 days, or GBP972.89.

The CTBV is then negative GBP464,963.80 as follows:

CTBV = e + f + g +h + i

CTBV = –484,048.96 + 33,275.86 + 0 – 0 – 14,190.70

CTBV = GBP464,963.80

Calculate income or expenditure in New Zealand dollars

The next step is to calculate income or expenditure in 2016/17 in New Zealand dollars.

The formula as set out above is:

accrual income or expenditure = a + b – c – d

The figure for 'a' is the closing tax book value of negative GBP464,963.80 divided by 0.5600, which was the exchange rate on 31 March 2017. The result is negative NZD830,292.50.

The figure for 'b' is zero as Adam received no further loans in the year.

The figure for 'c' is the opening balance of negative NZD1,005,920.53 from 2015/16.

The figure for 'd' is NZD61,744.31. This is the total of the monthly payments in British pounds converted into New Zealand dollars as shown in Table 4.

As in 2015/16, the table also shows interest converted into New Zealand dollars. Adam would use the total later in the deferral threshold calculation if required.

Table 4: Loan payments for 2016/17 converted to NZD

Dates	Monthly payment GBP	Interest GBP	Exchange rates	Monthly payment NZD	Interest NZD
5 Apr 2016	2,772.99	1,207.59	0.4775	5,807.30	2,528.99
5 May 2016	2,772.99	1,203.68	0.4748	5,840.33	2,535.12
5 Jun 2016	2,772.99	1,199.75	0.4775	5,807.30	2,512.57
5 Jul 2016	2,772.99	1,195.82	0.5438	5,099.28	2,199.01
5 Aug 2016	2,772.99	1,191.88	0.5472	5,067.60	2,178.14
5 Sep 2016	2,772.99	1,187.92	0.5495	5,046.38	2,161.83
5 Oct 2016	2,772.99	1,183.96	0.5646	4,911.42	2,096.99
5 Nov 2016	2,772.99	1,179.99	0.5869	4,724.80	2,010.55
5 Dec 2016	2,772.99	1,176.01	0.5585	4,965.06	2,105.65
5 Jan 2017	2,772.99	1,172.01	0.5669	4,891.49	2,067.41
5 Feb 2017	2,772.99	1,168.01	0.5860	4,732.06	1,993.19
5 Mar 2017	2,772.99	1,164.00	0.5716	4,851.27	2,036.39
Totals	33,275.86	14,230.63		61,744.31	26,425.84

Adam puts these figures into the formula as follows:

accural income or expenditure = a + b – c – d

accural income or expenditure = –830,292.50 + 0 – –1,005,920.53 – 61,744.31

accural expenditure = NZD113,883.72

The result of applying the formula is NZD113,883.72. The absolute value is the same amount. As this is over the income and expenditure threshold of NZD100,000, Adam needs to consider the financial arrangement threshold.

Note that even though Adam has borrowed money, there is income as the New Zealand dollar strengthened during the giving rise to a foreign exchange gain.

Financial arrangement threshold

The opening value of the loan was NZD1,005,920.53. This exceeds the financial arrangement threshold of NZD1 million.

As Adam has exceeded both the income and expenditure and financial arrangement thresholds, he cannot be a CBP and must do a CBA.

Electing to use a spreading method

66. A CBP may elect to calculate income or expenditure from an arrangement using a spreading method[24]. They can do this as long as it is not a year in which they must calculate a BPA.[25] They make the election by calculating a CBA.[26]

67. A CBP who chooses to use a spreading method must then use a spreading method for:
    - all financial arrangements they are a party to at the time of making the election; **and**
    - all financial arrangements they enter into after the income year in which they make the election.[27]

68. A person can revoke the election by giving notice to the Commissioner with a return of income within the prescribed timeframe.[28] The revocation applies to all financial arrangements entered into after the income year in which the person gives the notice.[29] However, a person must continue to use a spreading method for those arrangements covered by the election even though they may qualify to be a CBP.

69. Although the cash basis is generally seen as simpler, there are at least three reasons why a person may elect to account for income and expenditure on an accrual basis. First, the accrual basis may result in limited deferral of income or acceleration of expenditure compared to the cash basis. Second, a person may expect to breach the thresholds in a subsequent year and decide that it is easier to account for the financial arrangement on an accrual basis from the outset. Thirdly, as a CBP also has to do a BPA, it may also be easier to account for financial arrangements on an accrual basis from the beginning of the arrangement.

Cash basis adjustment

70. There are three circumstances in which a person may need to make a CBA in an income year. The effect of the CBA is to adjust a person's income or expenditure from the start of a financial arrangement to the end of the current income year for their new method of accounting or status.

When a cash basis adjustment is required

71. Section EW 62 sets out when a person needs to make a CBA. A CBA is required when a person:
    - elects to use a spreading method;[30] or
    - becomes a CBP; or
    - ceases to be a CBP.

[24] Section EW 61(1).

[25] Section EW 61(2).

[26] Sections EW 61(2) and EW 62(1).

[27] Section EW 61(4).

[28] Section EW 61(5) and s 37 of the Tax Administration Act 1994.

[29] Section EW 61(6).

[30] Electing to use a spreading method is covered from [66].

72. If a person is using a spreading method but qualifies to be a CBP and does not make a CBA, the person is not a CBP.[31]

73. There are some limited exceptions to having to make a CBA. If a person qualifies to be a CBP in an income year, they must not calculate a CBA:[32]

- if they choose to continue to use a spreading method in that year; or
- for a financial arrangement that they already account for on the cash basis.

74. Likewise, if a person ceases to be a CBP, they must not calculate a CBA for a financial arrangement that is already subject to a spreading method.[33]

Calculating the cash basis adjustment

75. A CBA is calculated using the formula in s EW 63. The CBA results in income or expenditure for the income year. A positive CBA is income and a negative CBA is expenditure.

EW 63 **Cash basis adjustment formula**

Formula

(1) A person calculates a cash basis adjustment using the formula—

adjusted income − adjusted expenditure − previous income + previous expenditure.

Definition of items in formula

(2) The items in the formula are defined in subsections (3) to (6).

Adjusted income

(3) Adjusted income is,—

(a) for a person who becomes a cash basis person, the amount that would have been income derived by the person under the financial arrangement if the person had been a cash basis person in the period starting on the date on which they became a party to the arrangement and ending on the last day of the income year for which the calculation is made; and

(b) for a person who ceases to be a cash basis person, the amount that would have been income derived by the person under the financial arrangement if the person had been required to use a spreading method in the period starting on the date on which they became a party to the arrangement and ending on the last day of the income year for which the calculation is made.

Adjusted expenditure

(4) Adjusted expenditure is,—

(a) for a person who becomes a cash basis person, the amount that would have been expenditure incurred by the person under the financial arrangement if they had been a cash basis person in the period starting on the date on which they became a party to the arrangement and ending on the last day of the income year for which the calculation is made; and

(b) for a person who ceases to be a cash basis person, the amount that would have been expenditure incurred by the person under the financial arrangement if the person had been required to use a spreading method in the period starting on the date on which they became a party to the arrangement and ending on the last day of the income year for which the calculation is made.

Previous income

(5) Previous income is income derived by the person under the financial arrangement in earlier income years.

Previous expenditure

(6) Previous expenditure is expenditure incurred by the person under the financial arrangement in earlier income years.

[31] Section EW 62(6).

[32] Section EW 62(3).

[33] Section EW 62(5).

76. The CBA formula is different depending on whether the person is becoming a CBP or ceasing to be one. Where a person becomes a CBP and needs to calculate a CBA, the terms in the formula have the following meanings:[34]
    - "adjusted income" is income they would have derived if they had been a CBP from the start of the financial arrangement to the last day of the income year for which the CBA calculation is being made;
    - "adjusted expenditure" is expenditure they would have incurred if they had been a CBP from the start of the financial arrangement to the last day of the income year for which the CBA calculation is being made;
    - "previous income" is the income they derived under the financial arrangement in earlier income years; and
    - "previous expenditure" is the expenditure they incurred under the financial arrangement in earlier income years.

77. If the person ceases to be a CBP, the terms in the formula mean the following:[35]
    - "adjusted income" is income they would have derived if they had been required to use a spreading method from the start of the financial arrangement to the last day of the income year for which the CBA calculation is being made;
    - "adjusted expenditure" is expenditure they would have incurred if they had been required to use a spreading method from the start of the financial arrangement to the last day of the income year for which the CBA calculation is being made;
    - "previous income" is the income they derived under the financial arrangement in earlier income years; and
    - "previous expenditure" is the expenditure they incurred under the arrangement in earlier income years.

78. *Example 7* carries on from *Example 6*. It shows the adjustment that Adam must make at the end of the 2016/17 income year on ceasing to be a CBP.

Example 7: Cash basis adjustment calculation for 2016/17

The formula for the CBA is:

CBA = adjusted income – adjusted expenditure – previous income + previous expenditure

In working out whether Adam has adjusted income or expenditure from the GBP500,000 loan, the calculations need to be made from when Adam obtained the loan on 5 April 2015 through to 31 March 2017 (the end of the income year for which he must make the CBA).

Adjusted income

Adam's adjusted income is negative NZD87,147.60 in the 2015/16 income year plus NZD113,883.72 in the 2016/17 year, which equals NZD26,736.12.

Adjusted expenditure

Adam has no adjusted expenditure.

Previous income

Adam returned no previous income.

Previous expenditure

Adam deducted NZD30,358.58 in the 2015/16 income year.

Calculation of the CBA

This leads to the following result:

CBA = 26,736.12 – 0 – 0 + 30,358.58

CBA = 57,094.70

The CBA for 2016/17 is income of NZD57,094.70.

The CBA puts Adam in the same position as if he had accounted for the financial arrangement on an accrual basis from the start of the financial arrangement to the end of the 2016/17 year. The correct position under the accrual basis is that Adam should return income of NZD26,736.12 from the start of the arrangement to the end of the 2016/17 income year. As Adam claimed expenditure of NZD30,358.58 in the 2015/16 income year, he needs to return income of NZD57,094.70 in the 2016/17 income year to achieve this result.

[34] Sections EW 63(3)(a), EW (4)(a), EW (5) and EW (6).

[35] Sections EW 63(3)(b), EW (4)(b), EW (5) and EW (6).

If Adam had instead made an election in 2015/16, he could have deducted NZD87,147.60 using a spreading method instead of NZD30,358.58 on a cash basis. However, he would need to continue using the spreading method in 2016/17 and return NZD113,883.72. The net result in terms of income over the two years is the same (i.e. NZD26,736.12 of accrual income) but the timing differs.

Accounting for the cash basis adjustment

79. Once the CBA has been calculated, s EW 62 sets out the next steps. Section EW 62(8) provides that the CBA is the only income or expenditure under a financial arrangement in an income year in which one is made.

80. Section EW 62(9) states that if the CBA is positive, then it is income under s CC 3(1) for the person in that income year. If the CBA is negative, then it is expenditure incurred by the person in the year the calculation is made. It is still necessary to consider whether that expenditure is deductible. The relevant deductibility provision is s DB 6 because financial arrangement expenditure is treated as "interest" under the definition in s YA 1.

81. Section DB 6 provides:

> **DB 6 Interest: not capital expenditure**
>
> *Deduction*
>
> (17) A person is allowed a deduction for interest incurred.
>
> *Exclusion*
>
> (18) Subsection (1) does not apply to interest for which a person is denied a deduction under section DB 1.
>
> …
>
> *Link with subpart DA*
>
> (19) This section overrides the capital limitation. The general permission must still be satisfied and the other general limitations still apply.

82. The interest expenditure must satisfy the general permission for deductibility in s DA 1. Where the financial arrangement in question is a foreign currency loan used to finance a foreign rental property, the general permission will likely be satisfied because of the nexus between the financial arrangement expenditure incurred and the rental income derived from the property that the loan finances.

83. Residential property deductions are generally "ring-fenced". This means they can only be used against income from residential property, with any deductions in excess of the income being carried forward to the next income year the taxpayer derives income from residential property. For further information on the residential ring-fencing rules, see "Ring-fencing of residential property deductions".[36]

84. Note also that the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 contained an amendment to the definition of "residential income" in s EL 3 so that foreign exchange gains on a loan can be offset against deductions. The same Act introduced the interest limitation rules which affect how much interest can be deducted in respect of residential rental property.[37]

References

Legislative references

Income Tax Act 2007, ss CC 1, CC 3, DA 1, DB 6, EL 3, EW 3, EW 4, EW 5, EW 9, EW 14, EW 29, EW 30, EW 31, EW 54, EW 55, EW 57, EW 59, EW 60, EW 61, EW 62, EW 63, EZ 33 to EZ 52D and YA 1 ("absolute value", "cash basis person", "fixed principal financial arrangement", "interest" and "variable principal debt instrument")

Tax Administration Act 1994, s 37

Other references

[36] *Tax Information Bulletin* Vol 31, No 8 (September 2019): 53.

[37] https://taxpolicy.ird.govt.nz/publications/2022/2022-sr-interest-limitation-bright-line-changes.

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https://taxpolicy.ird.govt.nz/publications/2022/2022-sr-interest-limitation-bright-line-changes

IR461 *Guide to foreign investment funds*, accessed from **www.ird.govt.nz/income-tax/income-tax-for-businesses-and-organisations/types-of-business-income/foreign-investment-funds-fifs**

TECHNICAL DECISION SUMMARIES

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TDS 22/13: Whether portable units are exempt supplies of accommodation in a dwelling

Technical decision summary - Adjudication

Decision date | Te Rā o te Whakatau: 4 April 2022

Issue date | Te Rā Tuku: 22 July 2022

Subjects | Ngā kaupapa

GST: exempt supplies of accommodation in a dwelling

Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

Commissioner or CIR	**Commissioner of Inland Revenue**
GST	Goods and services tax
GSTA	Goods and Services Tax Act 1985
PLA	Property Law Act 2007
RTA	Residential Tenancies Act 1986
TAA	Tax Administration Act 1994
TCO	Tax Counsel Office, Inland Revenue

Taxation laws | Ngā ture tāke

All legislative references are to the Goods and Services Tax Act 1985 (**GSTA**) unless otherwise stated.

Facts | Ngā meka

1. The Taxpayer rents portable self-contained units to its customers under a hire agreement. The units are delivered to, and installed on, the customer's property.
2. Under the hire agreement, the customer agrees that the unit will not be moved once it is installed. The portable unit remains a relocatable chattel and does not constitute a fixture or improvement on the land. The Taxpayer has the right to terminate the hire agreement and remove a portable unit if the terms of the agreement are breached.
3. Hire fees are paid weekly in advance. The hire agreement serves as the basis for the weekly payments, but a systems-generated invoice is raised each week for accounting reference and issued to the client on request.
4. The portable units typically serve as an extension to the customer's existing property. The portable units may be used as residential accommodation or commercial (office) premises. Where the purpose of the hire is not residential, GST is charged on the hire.

5. The delivery and site installation is charged with GST. The Taxpayer did not dispute that the delivery and installation fees are subject to GST.
6. The Taxpayer filed a GST return for the disputed period, returning GST on the hire of units for residential use. However, the Taxpayer subsequently issued a Notice of Proposed Adjustment proposing that this supply should be exempt, and therefore, should be entitled to a refund.

Issues | Ngā take

7. The main issues considered in this dispute were:
   - whether the hire of the portable units was a single supply or multiple supplies; and
   - whether there was an exempt supply of residential accommodation.

Decisions | Ngā whakatau

8. The Tax Counsel Office (**TCO**) decided that:
   - The supply of portable units under the hire agreement consists of multiple separate supplies. These supplies include a series of successive supplies of the hire of the portable units, deemed to occur under s 9(3)(a), and a separate supply of delivery and installation of the portable units.
   - The series of successive supplies of the portable units are not exempt supplies of "accommodation in a dwelling" under s 14(1)(c). The Taxpayer is therefore liable for GST on the supplies.

Reasons for decisions | Ngā take mō ngā whakatau

Issue 1 | Take tuatahi: Single supply or multiple supplies

9. Before determining whether the supply of the portable units was exempt, it is important to establish the true nature of the supply.[1]
10. The GSTA generally imposes tax on a supply of goods and services (s 8(1)), but some supplies are exempt, and some are zero rated. Where a supply may contain multiple components, and one or more components may be either exempt or zero rated, it is important to establish whether the supply is a single supply or multiple supplies.
11. The Taxpayer did not make detailed arguments on whether the supply of the portable units and the delivery and installation services were a single supply or multiple supplies, but, in practice, it appeared the Taxpayer treated them as separate supplies.
12. Customer & Compliance Services, Inland Revenue argued that there was a single composite supply, following the principles in Interpretation Statement IS 18/04: Goods and Services Tax – Single Supply or Multiple Supplies (IS 18/04).[2]
13. TCO considered that there were two provisions in the GSTA that could potentially apply to determine the nature of the supply in this dispute – s 5(15)(a) or s 9(3)(a).
14. Section 5(15)(a) may apply if there was a supply of real property[3] and the supply of portable units was considered a supply of a principal place of residence. However, TCO considered that s 5(15)(a) did not apply in this dispute because there are no supplies of real property provided by the Taxpayer to its customers. (Whether the supply of portable units is a supply of a principal place of residence is addressed later in the summary.)
15. Section 9(3)(a) provides that where goods are supplied under an agreement to hire, the supply is deemed to be a series of successive supplies, with each successive supply being deemed to be made when a payment becomes due or is received, whichever is earlier.

[1] *Marac Life Assurance Ltd v Commissioner of Inland Revenue* [1986] 1 NZLR 694 at 705 to 706 provides that the true nature of a transaction can only be ascertained by consideration of the legal arrangements actually entered into and carried out: not on an assessment of the broad substance of the transaction measured by the results intended and achieved or of the overall economic consequences.

[2] IS 18/04 sets out the Commissioner's view on determining whether a supply is a single supply or multiple supplies based on the principles from the New Zealand leading case *Auckland Institute of Studies Ltd v CIR* (2002) 20 NZTC 17,685. TCO considered that while IS 18/04 is not authoritative, it is correct and a useful summary of the law.

[3] Real property is "immovable property, such as land and anything erected on or attached to this" (Online ed, Oxford University Press, March 2022. OED 3rd Edition December 2008).

16. In this case, the portable units are hired under a hire agreement that provides for the temporary use of the portable unit in exchange for weekly payments. Therefore, s 9(3)(a) deems the supply of the portable units to be a series of successive supplies. Each time a weekly payment is made (or becomes due), there is another supply. The GSTA determines that these are multiple successive supplies and must be considered separately in determining whether they are exempt supplies. No issue of whether they are a single supply arises as the GSTA treats them as separate supplies.
17. The delivery and installation of the units are a one-off service that is provided at the beginning of the hire period and is invoiced separately from the weekly payments made for the hire of the unit. TCO considered that there is sufficient distinction between the components of the supply that it is reasonable to treat the delivery and installation as a separate supply to the hire for these reasons:
    - Because s 9(3)(a) treats the ongoing hire as a series of successive supplies, the delivery and installation services could only be a composite supply with the first of the successive supplies of the hire of the portable unit. When viewed from this perspective, the components of the supply being considered are the delivery and installation and the first week's rental of the portable unit.
    - Applying the principles in *Auckland Institute of Studies Ltd*[4], it was considered that the focus should be on the true and substantial nature of the consideration given by the Taxpayer to its customers. This is with a view to determine whether it is reasonable to sever the parts of the supply from each other – whether the supply was integral to another, or whether it was merely ancillary. Where the component of the supply is sought as an aim in itself, it may still be reasonable to treat the components of the supply as separate supplies, even if it is integral to another component of the supply.[5] While delivery and installation is a means of better enjoying the ongoing rental of the portable unit, the customers of the Taxpayer likely view delivery and installation as an aim in itself (not simply incidental to the ongoing hire of the portable unit).
    - The Taxpayer treated delivery and installation as a separate supply as reflected in the separate invoicing and consideration payable.
18. Consequently, the supplies being considered in the next issue are the series of successive supplies of the hire of the portable unit.

Issue 2 | Take tuarua: Exempt supply of accommodation in a dwelling

19. The Taxpayer contended that s 14(1)(c) applies to exempt the supply of the portable units. The specific supply in question is the series of successive supplies of the portable units.
20. As mentioned, s 8(1) imposes GST on the supply of goods and services, but not on exempt supplies.
21. Section 14(1)(c) provides that the supply of accommodation in any dwelling by way of hire or a service occupancy agreement or a licence to occupy is an exempt supply.
22. Therefore, for the supply of portable units to be exempt by s 14(1)(c), it must be a supply of:
    - accommodation
    - in a dwelling;
    - by way of hire.
23. Both parties accepted that the portable units are supplied by way of hire by the Taxpayer. So, the remaining issues to be considered by TCO were whether the supplies of portable units are supplies of "accommodation", and whether the portable units are "dwellings".

Accommodation

24. TCO concluded that the supply of the portable units was not a supply of accommodation in the context of s 14(1)(c) because:
    - Accommodation is not defined in the GSTA. The ordinary meaning of "accommodation" is a "room and provision for the reception of people, esp. with regard to sleeping, seating, or entertainment; living premises, lodgings".[6]

[4] *Auckland Institute of Studies Ltd* at [36] and [40].

[5] See also *CIR v Smiths City Group Ltd* (1992) 14 NZTC 9,14 (HC) where Tipping J noted that it is a matter of fact and degree whether there is sufficent distintion between the different parts to make it reasonable to sever them and apportion accordingly.

[6] OED Online, Oxford University Press, March 2022, www.oed.com/view/Entry/1134. OED 3rd edition, March 2011.

- In considering the meaning of accommodation it is important to keep the context in mind. While "accommodation" can mean a room or building, the word "accommodation", in the context of s 14(1)(c), refers to the right to stay in living premises or lodgings – it does not describe the physical nature of the dwelling, but describes a service being provided by the supplier.
- This is evident when the phrase "the supply of accommodation in any dwelling" is considered together. The supply of accommodation must be in a dwelling. If accommodation meant the physical premises, the section would refer to the supply of physical premises in a dwelling. That does not make sense. Instead, the section is referring to the supply of a service of providing lodgings or the right to stay in a dwelling.
- The Taxpayer is not supplying the right to stay, rather is supplying a physical structure. This physical structure could conceivably be used to supply accommodation, but that is not what is being supplied in this dispute.
- This conclusion is consistent with the legislative purpose of the provision to exempt the supply of accommodation in a dwelling from GST. The provision was intended to apply to situations where there was a reasonable level of substitutability between renting and owning a home. This is to ensure that owner-occupiers of residential dwellings are not placed in an advantageous position compared with those who rent.[7]

25. On this basis, the hire of the portable units is not the supply of accommodation in a dwelling. However, TCO went on to consider whether the portable units are "dwellings".

Dwelling

26. As Issue 1 established, the supply of the portable units is a series of successive supplies, and the supply of the delivery and installation is a separate supply to the supply of the units. TCO considered the definition of dwelling as it applies to the successive supply of the portable units, and not the delivery and installation of the units.
27. In considering the meaning of "dwelling" in s 14(1)(c) in the context of the successive supplies of the portable units, there are three key requirements:[8]
    - Whether the portable units are premises as defined in s 2 of the Residential Tenancies Act 1986 (**RTA**);
    - Whether the portable units are, or could reasonably be foreseen to be, occupied as a principal place of residence; and
    - Whether the Taxpayer's customers have quiet enjoyment, as that term is used in s 38 of the RTA.
28. The current definition of "dwelling" in s 2 was introduced in 2011 and explicitly refers to definitions from the RTA. The parties to the dispute referred to a number of cases that considered the definition of dwelling prior to its amendment in 2011.[9] TCO considered that while the cases are consistent with the conclusion reached on the meaning of accommodation above, the analysis focused on the current definition of "dwelling".
29. In order to meet the definition of dwelling, there must be a "premises" as defined in s 2 of the RTA. "Premises" generally means a building together with its surrounding land.[10] "Premises" is also defined to include mobile homes placed on land and intended for occupation.[11] However, case law establishes that its meaning in any particular situation likely depends on its context.[12] A consideration of the context and purpose of the use of the word "premises" is therefore important in ascertaining its meaning as it is used in the definition of "dwelling".
30. The context in which "premises" is used in the definition of "dwelling" includes the further concepts of "principal place of residence" and "quiet enjoyment". It also includes the purpose of s 14(1)(c) and what was intended to be exempt from GST, and the context of the RTA from which both "premises" and "quiet enjoyment" are expressly drawn. All of these sources of context have a common theme in that they refer to a landlord and tenant relationship:
    - "Principal place of residence" is further defined in s 2 as a place that a person occupies as their main residence for the period to which the agreement for the supply of accommodation relates. The purpose of this requirement in the

[7] See the *White paper: Proposals for the Administration of the Goods and Services Tax* (March 1985) and the *Commentary on the Taxation (GST and Remedial Matters) Bill* (August 2010).

[8] Definition of "dwelling" in s 2.

[9] See *Case R17* (1994) 16 NZTC 6,091 (TRA); *Case T44* (1998) 18 NZTC 8,295; *Wairakei Court Limited v Commissioner of Inland Revenue* (1999) 19 NZTC 15,202; *Case L75* (1989) 11 NZTC 1,435 (TRA).

[10] Definition of "premises" in OED Online, Oxford University Press, March 2022, OED 3rd Edition March 2007; *Kahi v Lucas* Auckland HC HC 81/96, 23 September 1996; *Wong and Wong v Lady Di Cruises*, TT 259/97, 24 February 1997.

[11] Paragraph (c) of the definition of "premises" in s 2 of the RTA.

[12] *Molina v Zaknich* [2001] WASCA 337 at [41] to [47] and *McKenna v Porter Motors Ltd* [1955] NZLR 832.

definition of "dwelling" is to ensure that the definition only applies to supplies of accommodation that are similar to living in your own home.[13]

- Section 38 of the RTA provides that a tenant is entitled to have quiet enjoyment of the premises without interruption by the landlord. A covenant of quiet enjoyment is not expressly provided in the hire agreement, nor could it be as there is no landlord and tenant relationship. According to s 281 of the Property Law Act 2007 (**PLA**), a covenant of quiet enjoyment can only be implied by statute. The only two statutes that imply a covenant of quiet enjoyment in relation to property are the PLA (applies to leases of land) and the RTA (applies to tenants under a tenancy agreement). Neither the PLA nor the RTA apply in this case to imply a covenant of quiet enjoyment, and therefore there cannot be quiet enjoyment as that term is used in s 38 of the RTA.
- As already noted, the purpose of s 14(1)(c) is to ensure that tenants are not charged GST on the rental they pay for accommodation, or to live in their home. The provision is aimed at landlords and tenants where the landlord is charging the tenant for the accommodation supplied by the landlord. Where the word "premises" can take different meanings, it must be given a meaning that is consistent with this purpose, and thus "premises" should mean something that is similar to what a tenant is supplied with or what a homeowner has.
- The RTA is an Act that governs all residential tenancies and defines the rights and obligations of landlords and tenants. "Premises" must therefore be capable of being the subject of a residential tenancy under the RTA.

31. Against this background, it needs to be determined whether the successive supplies of the portable units by the Taxpayer to its customers could be the supply of accommodation in a "dwelling" (although it has already been concluded that the supply is not one of accommodation).
32. The onus of proof in this case is on the Taxpayer.[14] The standard of proof is the balance of probabilities.[15] The Taxpayer needed to show that the portable units, once they are installed on a customer's land, are dwellings. This is because only the series of successive weekly supplies are being considered to determine whether they are exempt from GST (not the delivery and installation).
33. TCO considered that the portable units are not "dwellings", as defined in s 2 for these reasons:
    - The portable units are not "premises" as defined in s 2 of the RTA, as this word applies to situations where a residential tenancy exists, and the hire agreement is inconsistent with a residential tenancy. Further, treating these units as premises and exempting them under s 14(1)(c) would not serve the purpose of ensuring consistency of treatment between homeowners and renters.
    - The Taxpayer has not provided sufficient evidence to show that the portable units are, or could reasonably be foreseen to be, occupied as a "principal place of residence".
    - The Taxpayer also does not provide quiet enjoyment to its customers. As already noted, there is not an express covenant of quiet enjoyment in the hire agreement, nor can a covenant of quiet enjoyment be implied under the RTA or the PLA.

Issue 2 conclusion

34. The series of successive supplies of the portable units were not a supply of "accommodation". While it was not necessary to definitively conclude on this point, it was also concluded that the series of successive supplies of the portable units were not supplies of "dwellings" for the purposes of the exemption in s 14(1)(c).
35. The Taxpayer was therefore liable for GST on the supplies.

[13] *Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill* (Inland Revenue and the Treasury, October 2010).

[14] Section 149(2) of the Tax Administration Act 1994 (TAA) and *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271 (CA).

[15] Section 149(1) of the TAA, *Yew v CIR* (1984) 6 NZTC 61,710 (CA); *Birkdale Service Station Ltd v CIR* (1999) 19 NZTC 15,493 (HC), *Case Y3* (2007) 23 NZTC 13,028, and *Case X16* (2005) 22 NZTC 12,216.

TECHNICAL DECISION SUMMARIES

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TDS 22/14: GST and income tax: Liable as agent for tax obligations of a company?

Technical decision summary - Adjudication

Decision date | Te Rā o te Whakatau: 9 March 2022

Issue date | Te Rā Tuku: 25 July 2022

Subjects | Ngā kaupapa

GST and income tax: Is the Taxpayer liable as agent for a company's tax obligations under s 61 of the Goods and Services Tax Act 1985 and s HD 15 of the Income Tax Act 2007?

Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

CCS	Customer & Compliance Services, Inland Revenue
Commissioner	Commissioner of Inland Revenue
GST	Goods and services tax
GSTA	Goods and Services Tax Act 1985
ITA 2007	Income Tax Act 2007
NOPA	Notice of Proposed Adjustment
NOR	Notice of Response
SOP	Statement of Position

Taxation laws | Ngā ture tāke

All legislative references are to the Income Tax Act 2007 (**ITA 2007**) unless otherwise stated.

Facts | Ngā meka

Background

1. The Taxpayer is a citizen and resident of Australia and was the sole director and shareholder of a company, ABC Ltd (in liquidation) (**ABC**). The Taxpayer performed the services which are the subject of this dispute in New Zealand.
2. ABC was registered for GST on the payments basis. ABC's business was "Computer Programming Service". ABC did not have its own bank account, but an Australian company with a similar name (ABC Pty Ltd (**ABC Aus**)) did have a New Zealand bank account. The Taxpayer was the sole signatory on ABC Aus' bank account.

First agreement to provide services

3. The Taxpayer (trading as ABC) entered into a written agreement with XYZ Ltd (**XYZ**, a large New Zealand registered company). The Taxpayer (trading as ABC) agreed to provide services to XYZ. XYZ agreed to pay all reasonable disbursements incurred by ABC in the course of carrying out the services. All payments made by XYZ to ABC for the period in dispute were made to ABC Aus' bank account.
4. There was a factual dispute between Customer & Compliance Services (**CCS**) and the Taxpayer about whether ABC was an independent contractor to XYZ or whether the Taxpayer was an employee of XYZ.

Second agreement to provide services

5. A second New Zealand registered company was involved in the dispute, DEF Ltd (**DEF**). An Australian resident individual (who is apparently unrelated to the Taxpayer) was the sole director and shareholder of DEF. DEF was the corporate trustee for the DEF Trust (**Trust**).
6. CCS obtained a copy of an agreement between XYZ and DEF (and two subsequent variation agreements). The agreements were signed by the Australian resident individual. The services provided under the agreements included providing personnel who were based in New Zealand or Australia to XYZ.
7. DEF made payments to ABC Aus' bank account on a regular basis. DEF also made a number of payments to the Taxpayer's personal bank account.
8. CCS considered the payments DEF made into ABC Aus' bank account were for services that ABC provided to the Trust and/or DEF. The Taxpayer did not agree.

The New Zealand bank account

9. CCS reviewed ABC Aus' bank statements and found:
    - There was a regular pattern of funds being transferred to Australia.
    - Once a payment was received into ABC Aus' bank account from XYZ or DEF, funds were transferred to an Australian bank account or transferred to the Taxpayer's joint account with his spouse.
    - This left just enough to cover the Taxpayer's private costs until the next payment was received.
    - No surplus was retained or built up.
    - When the contract with XYZ was completed there were no funds left in ABC Aus' bank account.
    - All funds had been transferred to Australia.

Assessments issued by the Commissioner

10. Following an investigation, CCS issued assessments of GST and income tax to ABC. The assessments increased the amount of tax payable by treating certain payments made into ABC Aus' bank account as outputs for GST and income for income tax purposes. The assessments were not disputed by ABC and were deemed to be accepted. Consequently, these assessments are not in dispute.

Notice of disputable decision

11. Shortly after the assessments of GST and income tax were issued to ABC, CCS issued a notice of disputable decision and assessment determining that the Taxpayer was personally liable, as agent, for the GST and income tax debts of ABC under s 61 of the Goods and Services Tax Act 1985 (**GSTA**) and s HD 15.
12. The Taxpayer disputes that they were liable for ABC's tax debts.

Issues | Ngā take

13. The issue for decision by the Tax Counsel Office was whether the Taxpayer was liable as agent for ABC's tax obligations for the relevant periods under s 61 of the GSTA and s HD 15.
14. As noted above at [4], the Taxpayer also raised an issue regarding whether they were an employee of XYZ. While this was a matter relating to the Taxpayer's assessments, the Tax Counsel Office considered it to be outside the scope of their report because ABC did not dispute the assessments and was deemed to have accepted the liability. The parties' arguments regarding this issue are briefly summarised below at [16]-[19] as a preliminary issue.

Decisions | Ngā whakatau

15. The Tax Counsel Office decided that the Taxpayer was liable as agent for ABC's tax obligations for the relevant periods under s 61 of the GSTA and s HD 15.

Reasons for decisions | Ngā take mō ngā whakatau

Preliminary issue | Take tōmua: Was the Taxpayer an employee?

16. The Taxpayer argued that the contract entered into with XYZ was an employment agreement. Therefore, the Taxpayer argued that (as an employee) they could not be subject to s 61 of the GSTA and s HD 15. CCS argued that the facts did not support the view that the Taxpayer was an employee. CCS considered that the Taxpayer was an independent contractor.
17. The Tax Counsel Office discussed the main common law tests for determining employment status – the intention, control, fundamental, integration and independence tests – and noted the importance of bearing in mind that the application of the common law tests is a weighing-up process:[1]
    - Sometimes the facts of a particular case may suggest different characterisations of the relationship, and there may be either overlap or tensions between the tests.
    - Also, as the characterisation of the relationship is dependent on the particular facts at hand, it is crucial that the facts are well understood, including any changes to the relationship that have occurred over time.

Applying the tests to the facts of a case required an objective weighing of the various relevant factors to determine the true nature of the relationship.

18. The Tax Counsel Office noted that its analysis was consistent with the Commissioner's Interpretation Guideline *IG 16/01: Determining employment status for tax purposes (employee or independent contractor?)*.
19. The Tax Counsel Office concluded that:
    - The common law tests indicated the Taxpayer was not an employee of XYZ.
    - There was no evidence giving any reason to depart from the clear wording of the agreement, which specified that ABC was not an employee and contained clear terms consistent with that statement.
    - Even if the Taxpayer was an employee, this would not have a notable impact on the overall tax liability payable by the Taxpayer. This was because ABC would be liable to account for GST charged regardless, and the Taxpayer would be required to account for PAYE not withheld from payments made by XYZ (s RD 21).

Issue | Take: Was the Taxpayer liable as agent for ABC's tax obligations under s 61 of the GSTA and s HD 15 of the ITA 2007?

Section HD 15

20. Section HD 15 permits income tax owing by a company to be recovered from the company's directors and shareholders where an arrangement has been entered into which has an effect that the company cannot meet a tax liability.
21. Similarly, GST owing by a company may also be recovered from the company's directors and shareholders under s HD 15. Section HD 15 applies for the purpose of the GSTA as if the terms "income tax" and "tax" read "goods and services tax".
22. Section HD 15(1) sets out four requirements that must be met before s HD 15 will apply:
    - an arrangement has been entered into in relation to a company
    - an effect of the arrangement is that the company cannot meet a tax liability (either an existing liability or one that arises later)
    - it is reasonable to conclude that a purpose of the arrangement is that the company cannot meet a tax liability, and
    - it is reasonable to conclude that if a director of the company at the time of the arrangement made reasonable inquiries, they could have anticipated at the time that the tax liability would, or would likely, be required to be met.

[1] See in particular *TNT Worldwide Express Ltd v Cunningham* [1993] 3 NZLR 681 (CA) and *Bryson v Three Foot Six Ltd* (2005) 22 NZTC 19,242 (SC).

Was there an arrangement?

23. An arrangement is an agreement, contract, plan or understanding. The term "arrangement" is defined in s YA 1 as follows:

> **arrangement** means an agreement, contract, plan, or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect

24. The definition states that the contract, agreement, plan, or understanding need not be enforceable. The definition of "arrangement" also explicitly includes all steps and transactions by which the arrangement is carried into effect.

25. It is necessary to consider all of the relevant dealings or set of circumstances between the parties to determine if there is an arrangement. An "arrangement" is not limited to a single document or transaction.[2] The test is whether the relevant documents, transactions, dealings or set of circumstances are sufficiently interrelated or interdependent to be considered a single arrangement.[3]

26. The Tax Counsel Office considered that there was an arrangement in this case because:

- This was not a simple series of sequential events that just occurred as a result of developing circumstances (as argued by the Taxpayer).
- Each step was interrelated concerning the use and treatment of amounts paid by XYZ and DEF over a number of years.
- Some elements on their own may have been simple business decisions by ABC.
- However, taken together, all the elements demonstrate that the steps were planned as part of a wider arrangement.

Effect of the arrangement

27. The Courts have ruled that an effect of an arrangement is a result or consequence of the arrangement. Determining an effect of an arrangement is an objective test having regard to the outcome or outcomes of the arrangement itself. The motives of the parties are irrelevant.[4]

28. Section HD 15 should apply in situations where before an arrangement takes effect a company was able to satisfy a tax liability (either an existing liability or one that arises later) but an effect of the arrangement is that the company cannot meet the tax liability.[5]

29. Section HD 15 should not apply if the arrangement has no effect on the company's ability to meet the tax liability. If a company cannot meet an existing or expected tax liability regardless of the arrangement it is unlikely to be an effect of the arrangement that the company cannot meet the tax liability.

30. The TRA decided in *Case X11* that s HK 11 of the ITA 1994 (an earlier equivalent of s HD 15) applied where an effect of an arrangement involved the depletion of the assets of a company with the result that the company could not meet an existing or future tax liability. The TRA stated that *something* about the arrangement must produce the result that the company cannot meet a tax liability—that *something* must involve depleting the assets of the company.

31. Since ABC had limited other expenses, and these other expenses were met using only a small portion of the funds paid to ABC, it is reasonable to conclude that if the bulk of these funds had not been diverted overseas, ABC would have been able to meets its tax liability with no difficulty. Accordingly, the Tax Counsel Office considered that an effect of the arrangement (specifically the stripping of assets by transferring them to Australian bank accounts) was to leave ABC in a position where it was unable to meet its tax liability.

Purpose of the arrangement

32. The purpose of an arrangement has been considered in the context of the general antiavoidance provision s BG 1 and earlier equivalent provisions. By definition a tax avoidance arrangement is an arrangement that has tax avoidance as its *purpose or effect* (s YA 1). In this context the purpose of an arrangement has been said to mean the effect which it sought to achieve or its intended effect.[6]

[2] *Tayles v CIR* (1982) 5 NZTC 61,311 (CA) at 61,318.

[3] *CIR v Penny and Hooper* [2010] NZTC 15,433 (CA) at 15,451, *CIR v Europa Oil* [1971] NZLR 641 (PC) at 651, *AMP Life Limited v CIR* (2000) 19 NZTC 15,940 (HC).

[4] *Auckland Harbour Board v CIR* (1999) 19 NZTC 15,433 (CA) at 15,451, *CIR v BNZ Investments Ltd* (2001) 20 NZTC 17,103 (CA), *Peterson v CIR* (2005) 22 NZTC 19,098 (PC) at 34, *Newton v FCT* [1958] 2 All ER 759 (PC) at 764.

[5] *Case X11* (2005) 22 NZTC 12,175.

[6] *Tayles v CIR* (1982) 5 NZTC 61,311 (CA) at 734, *Ashton v CIR* (1975) 2 NZTC 61,030 (PC), *Glenharrow Holdings Ltd v CIR* (2009) 24 NZTC 23,236 (SC).

33. The wording of s HD 15(1)(c)(i) is different to the wording of the general antiavoidance provision s BG 1. Section HD 15(1)(c)(i) refers only to the relevant arrangement's purpose. It requires that a purpose of the arrangement is to have the effect described in s HD 15(1)(b), ie that the company cannot meet a tax liability. Section HD 15(1)(c)(i) does not require the purpose to be that effect. The wording of s HD 15(1)(c)(i) suggests that the required purpose is the arrangement's intended purpose. Whether the arrangement has the required purpose involves considering the arrangement itself and the effect described in s HD 15(1)(b) (ie that the company cannot meet a tax liability), to determine whether a reason or an object of the arrangement was to have that effect.
34. Section HD 15(1)(c)(i) uses an indefinite article in the phrase "**a** purpose of the arrangement" (emphasis added). This means that it will be sufficient if any purpose of the arrangement was that the arrangement would have an effect involving the depletion of the assets of a company with the result that the company cannot meet an existing or future tax liability. It is not necessary for the purpose to have been the sole, dominant, or principal purpose.
35. The facts show:
    - the Taxpayer's living and operating expenses were being met, and
    - the Taxpayer was living in Australia and was only in New Zealand to work for XYZ and DEF.
36. CCS argued that:
    - the only reason additional funds would have been left in New Zealand would be to meet tax liabilities, and
    - since funds were not left in the account for the purpose of meeting tax liabilities, this demonstrates a purpose of the arrangement was that ABC could not meet its tax liabilities.
37. The Taxpayer did not give any explanation why funds were kept in New Zealand to meet every ongoing expense except tax. Therefore, in the light of this and agreeing with CCS's arguments, the Tax Counsel Office considered it reasonable to conclude that a purpose of the arrangement was for the Company to be unable to meet its tax liability.

Reasonable to conclude that a director could have anticipated the tax liability

38. The issue is whether it is reasonable to conclude that if a director of the company, at the time of the arrangement, made reasonable inquiries they could have anticipated that a tax liability would, or would likely, be required to be met (s HD 15(1)(c)(ii)).
39. It must be possible for the director to have anticipated that the tax liability would or would likely be required to be met. In *Commissioner of Police v Ombudsman* Jeffries J said that the words "would be likely" as used in s 6 of the Official Information Act 1982 meant that there was a distinct or significant possibility the result might occur.[7]
40. Adopting a similar approach to Jeffries J, the Tax Counsel Office considered that for the purposes of s HD 15(1)(c)(ii) the director must have been able to anticipate that:
    - the relevant tax liability would be required to be met, or
    - there was a distinct or significant possibility that the relevant tax liability would be required to be met.
41. The Tax Counsel Office considered it highly unlikely that a director of a company (making significant amounts of money from contract engagements) would not realise, on making reasonable inquiries, that GST outputs would need to be accounted for on GST charged, or that a company's income was not being returned for income tax purposes.
42. In addition, even if the Taxpayer thought that he was an employee (which was not accepted by the Tax Counsel Office), the agreement was clear that ABC would be required to account for all its tax obligations. And, it would have been obvious that the amounts paid by XYZ did not have PAYE deducted.
43. For these reasons, the Tax Counsel Office considered it reasonable to conclude that the Taxpayer, the sole director of ABC, could have anticipated that the tax liability would be required to be met.

[7] *Comr of Police v Ombudsman* [1985] 1 NZLR 578 (HC) at 589.

Conclusion

44. The Tax Counsel Office concluded that all of the requirements in s 61 of the GSTA and s HD 15 were met because:
    - The Taxpayer, ABC, and ABC Aus (both companies operated by the Taxpayer) engaged in an arrangement that involved:
        - receiving payments into ABC Aus' New Zealand bank account
        - quickly transferring the bulk of the payments to Australian bank accounts under the Taxpayer's control
        - causing ABC's tax liability to be understated in tax returns that were filed with Inland Revenue, and
        - filing nil returns.
    - Looked at objectively, this arrangement had an effect of depleting ABC's assets almost completely on a regular basis, which left ABC unable to meet its tax liability, or any expected tax liability that would naturally arise from the activities ABC engaged in.
    - It was reasonable to conclude that:
        - a purpose of the arrangement was ABC could not meet its tax liability as funds were kept in New Zealand only if they were needed to meet the Taxpayer's and ABC's other expenses. All of these other expenses were met except ABC's tax liability, and funds were not retained in the account to meet any expected tax liability that might arise, and
        - the Taxpayer, as sole director of ABC, could have anticipated that ABC's tax liability would arise.

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TDS 22/15: Deductibility of depreciation and expenses

Technical decision summary - Adjudication

Decision date | Te Rā o te Whakatau: 11 March 2022

Issue date | Te Rā Tuku: 03 August 2022

Subjects | Ngā kaupapa

Income Tax: Deductions for expenses and depreciation; quantum of losses carried forward; depreciation of pooled assets.
Tax Administration Act 1994: Deemed acceptance.

Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

CCS	Customer and Compliance Services, Inland Revenue
Commissioner	Commissioner of Inland Revenue
TAA	Tax Administration Act 1994
TCO	Tax Counsel Office, Inland Revenue
CNOPA	Notice of Proposed Adjustment issued by the Commissioner
TNOR	Notice of Response issued by the Taxpayer
TSOP	Statement of Position issued by the Taxpayer

Taxation laws | Ngā ture take

All legislative references are to the Income Tax Act (ITA 2007) unless otherwise specified.

Facts | Ngā meka

1. The Taxpayer is a company and owned two properties, Property A and Property B. The Taxpayer was put into liquidation in late 2013 but the liquidators obtained an order terminating the liquidation in mid-2014.
2. Property A was leased by the Taxpayer to various businesses. Property B was purchased as a going concern which had been originally set up as a tourist venture.
3. The Customer and Compliance Services group (**CCS**) issued a Notice of Proposed Adjustment to the Taxpayer (**CNOPA**). The CNOPA contained a range of proposed adjustments. The Taxpayer issued a Notice of Response (**TNOR**). In the TNOR, the Taxpayer disputed CCS's proposal to disallow deductions for rates and depreciation incurred on Property B. The Taxpayer also claimed an entitlement to deduct certain legal fees.
4. The Taxpayer issued a Statement of Position (**TSOP**). In the TSOP, the Taxpayer purported to dispute an adjustment that they did not dispute in the TNOR; that is, a proposal to reduce depreciation claimed on a pool of assets located at Property A.

5. No agreement between the Taxpayer and CCS was achieved and the matter was referred to the Tax Counsel Office (**TCO**), Inland Revenue for adjudication.

Issues | Ngā take

6. The main issues considered in this dispute were:
   - Whether the Taxpayer was entitled to deduct expenses and depreciation in relation to Property B.
   - Whether the Taxpayer was entitled to deduct legal fees.
   - The quantum of loss balances available to carry forward.
   - Calculation of depreciation losses for pooled assets.
7. There were also preliminary issues on the onus and standard of proof as well as deemed acceptance under s 89H of the Tax Administration Act 1997 (TAA).

Decisions | Ngā whakatau

8. TCO decided that:
   - The Taxpayer was not entitled to the depreciation and rates deductions they claimed in relation to Property B.
   - The Taxpayer was not entitled to deduct legal fees in any of the years in dispute.
   - The Taxpayer had not shown that the loss carried forward amounts calculated by CCS were incorrect.
   - The Taxpayer was deemed to have accepted CCS's proposal to reduce the depreciation on the pool of assets at Property A but observed that the Taxpayer's arguments were not correct in any event.

Reasons for decisions | Ngā take mō ngā whakatau

Preliminary Issues | Take tōmua

Onus and standard of proof

9. The onus of proof in civil proceedings[1] is on the taxpayer, except for shortfall penalties for evasion or similar act, or obstruction.[2] The taxpayer must prove that an assessment is wrong, why it is wrong, and by how much it is wrong.[3]
10. The standard of proof in civil proceedings is the balance of probabilities.[4] This standard is met if it is proved that a matter is more probable than not. Whether the Taxpayer discharged the onus of proof is considered in the other issues.

Deemed acceptance

11. In the CNOPA, CCS proposed a series of adjustments that fell into 13 separate categories (the specific adjustments). In the TNOR, the Taxpayer disputed three of these: CCS's proposal to disallow a loss carried forward to the 2013 year and their proposals to disallow rates and depreciation (as they did not meet the requirements of ss DA 1 and EE 6) claimed in relation to Property B. The Taxpayer also disputed CCS's proposal to disallow depreciation deductions claimed in relation to the Pooled Assets located at Property A. However, the Taxpayer disputed this adjustment in the TSOP.
12. After the TNOR was issued CCS accepted the Taxpayer's position concerning the loss carried forward to the 2013 year and the parties resolved another of the specific adjustments by agreement.
13. Accordingly, with the exception of CCS's proposal to disallow expenses and/or depreciation relating to Property B and the Pooled Assets located at Property A, the Taxpayer did not produce any evidence or raise any arguments for the purpose of disputing the specific adjustments that had not been resolved by agreement. As the Taxpayer had not disputed these adjustments, the Taxpayer had not discharged the onus of proving that they were wrong.

[1] Challenge proceedings (ie, the proceedings that would follow if this dispute proceeds to the Taxation Review Authority or a court) are civil proceedings.

[2] Section 149A(2) of the Tax Administration Act 1994 (TAA).

[3] *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271 (CA); *Beckham v CIR* (2008) 23 NZTC 22,066 (CA).

[4] Section 149A(1) of the TAA; *Yew v CIR* (1984) 6 NZTC 61,710 (CA); *Birkdale Service Station Ltd v CIR* (1999) 19 NZTC 15,493 (HC); *Case X16* (2005) 22 NZTC 12,216; *Case Y3* (2007) 23 NZTC 13,028.

14. Section 89H(1) of the TAA also applies in this dispute. Section 89H(1) deems the Taxpayer to have accepted any of the specific adjustments that the Taxpayer has not rejected in the TNOR. This means that the Taxpayer is deemed to have accepted all of the specific adjustments in the CNOPA except the adjustments resolved by agreement between the parties and CCS's proposal to disallow rates and depreciation on Property B.

Issue 1 | Take tuatahi: Deductions of rates and depreciation

15. To establish that a deduction for expenditure or loss, including a depreciation loss, is allowable under the general permission in s DA 1 a taxpayer must show that:
    - they have incurred[5] the expenditure or loss; and
    - the expenditure has a sufficient nexus or relationship with the gaining or producing of the taxpayer's assessable income or with the carrying on of a business for that purpose.[6]
16. This inquiry involves the identification of the relationship between the advantage gained or sought to be gained by the expenditure and the taxpayer's income earning process.
17. Whether or not an expenditure or loss meets the requirements of the general permission is a question of fact and degree.
18. In each case, the true character of the particular expenditure or loss must be determined.
19. Whether a business exists involves a twofold inquiry into:[7]
    - the nature of the activities carried on.
    - the intention of the taxpayer in engaging in those activities.
20. Factors relevant to the inquiry include:
    - the period over which the activities are engaged in;
    - the scale of operations and the volume of transactions;
    - the commitment of time, money, and effort;
    - the pattern of activity;
    - the financial results.
21. A person will have a depreciation loss if they own an item of depreciable property for which a loss is calculated under ss EE 9 to EE 11.
22. An item of tangible property will be depreciable property if the following requirements are met:
    - the item is property;
    - the item is one that, in normal circumstances, might reasonably be expected to decline in value;
    - the item is used or available for use in deriving assessable income or in carrying on a business for the purpose of deriving assessable income;
    - the item is not described in the list in s EE 7 [What is not depreciable property?].
23. Pursuant to s EE 9(1), a person who owns an item of depreciable property calculates the depreciation loss for the property by applying either the straight line method or the diminishing value method. A person who owns depreciable property that is "poolable property" as that term is defined in s EE 66, may elect to use the pool method.
24. Sections EE 14 to s EE 19 apply for the purpose of calculating a depreciation loss that a person has if they use the diminishing value method or the straight line method (s EE 9(1)). Section EE 14(1) provides that a person's depreciation loss is the lesser of the amounts in ss EE 15 and EE 16.
25. The Taxpayer did not produce any evidence that a business or other type of income earning operation was carried on from Property B during the years in dispute. There was no evidence of income derived from the property, there was no evidence of any business operations carried on from or in relation to the property, and there was no evidence which would otherwise suggest that the property was employed in an income earning operation. Further, one of the Taxpayer's shareholders and directors made statements to CCS and to the liquidator of the Taxpayer that the business carried on from the property had ceased. There were similar statements in a valuation of the property prepared by a real estate agent.

[5] *A M Bisley & Co Ltd & Ors v CIR* (1985) 7 NZTC 5,082. Affirmed by the Privy Council in *CIR v Mitsubishi Motors New Zealand Ltd* (1995) 17 NZTC 12,351 (PC) at 12,353.

[6] *CIR v Banks* [1978] 2 NZLR 472 (CA), *Buckley & Young Ltd v CIR* [1978] 2 NZLR 485 (CA); (1978) 3 NZTC 61,271.

[7] *Grieve v CIR* (1984) 6 NZTC 61,682 (CA), at 61,691, and see also *Calkin v CIR* (1984) 6 NZTC 61,781 (CA).

26. These circumstances showed that during the years in dispute, Property B was not used in gaining or producing the Taxpayer's income. Consequently, the Taxpayer has not proved that the rates incurred on Property B had any connection with the Taxpayer's income or with a business carried on by the Taxpayer. As such, the Taxpayer had not established an entitlement to deduct the rates under the general permission in s DA 1.
27. The assets in respect of which the Taxpayer claimed depreciation deductions consist of the buildings and the chattels at Property B. The Taxpayer had not shown that a business was carried on from Property B or that Property B was in any other way used to derive income during the years in dispute. Further, the buildings and the chattels were inoperative and they were not a part of any underlying income earning operation in which they could have been deployed. Consequently, the assets were not used or available for use in deriving income or in carrying on a business for the purpose of deriving income. This means the assets were not items of "depreciable property". Consequently, the Taxpayer was not entitled to the depreciation deductions they claimed in relation to the assets.
28. CCS calculated the depreciation losses that the Taxpayer would be entitled to deduct if it was found that the buildings and chattels were depreciable property. The Taxpayer did not dispute CCS's methodology or the correctness of CCS's calculations. Therefore, the Taxpayer had not proved that CCS's alternative assessments were wrong. As such, the amounts calculated by CCS apply for assessment purposes if the dispute progresses and it is found that the assets are depreciable property.

Issue 2 | Take tuarua: Deduction of legal fees

29. In the TNOR the Taxpayer argued that they were entitled to deduct legal fees that relate to a tenancy matter. An account statement and bank payment advice form provided by the Taxpayer were evidence of legal fee obligations incurred by the Taxpayer. All of the dates on the documents occur in the income year immediately post those in dispute. Therefore, the documents were consistent with CCS's position that the debt obligations the documents relate to were incurred in the income year after the periods in this dispute. The Taxpayer did not argue that this was incorrect or provided evidence that would indicate the legal fees were incurred in any other year. As such, the Taxpayer had not shown that CCS's position (to deny deduction in the years in dispute) was wrong.
30. Section BD 4 requires a person to allocate a deduction for expenditure to the income year in which the expenditure was incurred. In the context of the general permission, the word "incurred" has been held by the courts to mean a taxpayer must have paid for or become "definitively committed" to an item of expenditure and that the expenditure must constitute an existing obligation which arose in the income year in question.
31. Therefore, if the Taxpayer considers that the legal fees meet the requirements for deductibility, the Taxpayer should claim them in the correct income tax return.

Issue 3 | Take tuatoru: Loss balances

32. Section IA 2(1) provides that a person's "tax loss" for a tax year, is calculated by adding together the amounts described in ss IA 2(2) to (4). The amounts in ss IA 2(2) and IA 2(3) are: (i) any "net loss" that the person has under s BC 4; and (ii), any loss balance the person has carried forward under s IA 3(4), but only to the extent that it Is not subtracted from the person's net income under s IA 4(1)(a).
33. The Taxpayer argued that they had loss balances available to be carried forward at amounts higher than that allowed by CCS. These amounts were the loss balances that the Taxpayer claimed in their 2014 and 2015 income tax returns. As such, they did not take account of the adjustments that CCS proposed. This approach was incorrect. Calculating a person's tax loss for a tax year requires that the person's net income or net loss for the year be taken into account. Further, in calculating the Taxpayer's net loss and net income figures in the 2013-2015 income years it was necessary to take account of the adjustments that CCS was proposing in those years. This is because the adjustments had either been accepted by the Taxpayer, or to the extent that they had been disputed, the Taxpayer did not prove that the adjustments were wrong.
34. As the Taxpayer had not taken account of the adjustments, the amounts they contended were their loss balances available to be carried forward will be incorrect if and when new assessments that take account of CCS's proposed adjustments are made. The adjustments that CCS proposed produced consequential changes to the Taxpayer's net income, net loss, tax loss and loss balance figures, as applicable, in each of the years in dispute. TCO considered the amounts calculated by CCS to be correct.

Issue 4 | Take tuawhā: Depreciation losses – pooled assets

35. The pool method for calculating the amount of a depreciation loss is contained in s EE 21. In relation to Property A, the Taxpayer claimed deductions for depreciation losses incurred in relation to pooled assets. In the CNOPA, CCS proposed to reduce the deductions on the ground that the Taxpayer had applied an incorrect cost base when calculating the deductions. The Taxpayer did not reject these adjustments in the TNOR. Consequently, s 89H deems the Taxpayer to have accepted the adjustments and the Taxpayer cannot now challenge them.

36. Despite the inability to further dispute or challenge this matter, the Taxpayer purported to dispute the adjustments in the TSOP. As the Taxpayer was deemed to have accepted the adjustments, those arguments could not succeed.

37. However, TCO made some brief observations on the issue. They remarked that the adjusted tax value of a pool of assets is found by aggregating the cost of each item in the pool and subtracting all depreciation deductions that have previously been allowed. The courts have held in general terms, the "cost" of something is the amount that must be given up to obtain it.[8] Similarly, in a depreciation context the courts have held that the cost of a depreciable asset is the entire amount that has been laid out to acquire the asset.[9] "Cost" is not limited to expenditure in money and determining the cost of something can involve viewing transactions in their commercial reality.[10]

38. The cost was the amount that the Taxpayer gave up or laid out in order to acquire the pool of assets at Property A. To ascertain this, CCS referred to the terms of a deed the Taxpayer entered into to acquire the assets. TCO confirmed that CCS's calculations were correct even though as noted above there was deemed acceptance by the Taxpayer on this issue.

[8] *Kettle River Sawmills Ltd v MNR* (1993) 64 NR 241 at 249.

[9] *BP Refinery (Kwinana) Ltd v FCT* 8 AITR 113.

[10] *Tasman Forestry Limited v CIR* (1999) 19 NZTC 15,147 (CA).

TECHNICAL DECISION SUMMARIES

Technical decision summaries (TDS) are summaries of technical decisions made by the Tax Counsel Office. As this is a summary of the original technical decision, it may not contain all the facts or assumptions relevant to that decision. A TDS is made available for information only and is not advice, guidance or a "Commissioner's official opinion" (as defined in s 3(1) of the Tax Administration Act 1994). **You cannot rely on this document as setting out the Commissioner's position more generally or in relation to your own circumstances or tax affairs**. It is not binding and provides you with no protection (including from underpaid tax, penalty or interest).

TDS 22/16: Non-resident supplier – application for GST registration

Technical decision summary - Adjudication

Decision date | Te Rā o te Whakatau: 17 December 2021

Issue date | Te Rā Tuku: 03 August 2022

Subjects | Ngā kaupapa

GST: Non-resident application; whether registered for overseas consumption tax or carrying on a taxable activity that if carried out in New Zealand would render the person liable to be registered for GST; whether making or intending to make taxable supplies in New Zealand; whether making or intending to make a supply in New Zealand.

Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

CCS	Customer and Compliance Services, Inland Revenue
Commissioner	Commissioner of Inland Revenue
GSTA	Goods and Services Tax Act 1985
TCO	Tax Counsel Office, Inland Revenue

Taxation laws | Ngā ture take

All legislative references are to the Goods and Services Tax Act 1985 (**GSTA**) unless otherwise specified.

Facts | Ngā meka

1. This Taxpayer lives outside New Zealand and is a non-resident for the purposes of the GSTA. The Taxpayer purchased two thoroughbred horses in New Zealand in January and April 2021.
2. The Taxpayer applied to be registered under s 54B of the GSTA from 1 January 2021.
3. The Taxpayer referred to two types of activities that are relevant to their application. First, buying and leasing horses in New Zealand and selling the horses offshore (**the New Zealand activities**). And second, bloodstock activities carried on overseas (**the overseas activities**).
4. Broadly, s 54B allows the Commissioner to register a non-resident who is not otherwise liable to be registered under s 51(1) if the Commissioner is satisfied that the non-resident:
   - is registered in respect of a consumption tax in the country of which they are a resident; or
   - carries on a taxable activity at a level that if carried on in New Zealand, would render the non-resident liable to be registered under s 51(1).

5. The Commissioner must also be satisfied that the non-resident meets various requirements which are set out in ss 54B(1)(b)-(e). Of particular relevance to the dispute are ss 54B(1)d)(i) and s 54B(1)(d)(ii). Those provisions provide, respectively, that the Commissioner must be satisfied that the non-resident is not making or intending to make:
   - a taxable supply in New Zealand; or
   - a supply in New Zealand to an unregistered person that would be a taxable supply if the non-resident was registered under s 51.
6. Customer and Compliance Services, Inland Revenue (**CCS**) declined the Taxpayer's application on the ground that they did not meet the requirements of s 54B. In support of their position, CCS said that information in letters provided in support of the application from the Taxpayer's overseas accountants showed that the Taxpayer was not registered for a consumption tax in their country of residence for the period in dispute. Further, the Taxpayer had not provided sufficient information to satisfy the Commissioner that they were carrying on a taxable activity overseas and information in the tax report showed that the Taxpayer's overseas activity would not render him liable to be registered in New Zealand if it was carried on in New Zealand.
7. CCS also stated that the Taxpayer may be excluded from registration under s 54(1)(d)(i) on the ground that they are making or intending to make taxable supplies in New Zealand. CCS said that the leasing of the horses and the eventual sale of the horses may constitute taxable supplies for the purposes of the GSTA. Similarly, CCS argued that the Taxpayer may be excluded from registration under s 54(1)(d)(ii) because they are making or intending to make a supply in New Zealand that would be a taxable supply if the Taxpayer was registered under s 51 and the supply was made to an unregistered person. In this regard, CCS stated that the supply of the horses by way of lease may come within s 54B(1)(d)(ii).
8. No agreement between the Taxpayer and CCS was achieved and the matter was referred to the Tax Counsel Office (**TCO**), Inland Revenue for adjudication.

Issues | Ngā take

9. The main issues considered in this dispute were:
   - Whether the Taxpayer was registered for a consumption tax in their country of residence (**Section 54B(1)(a)(i)**).
   - Whether the Taxpayer was carrying on a taxable activity in their country of residence and the level of that taxable activity would render them liable to be registered for GST if they were carrying out the taxable activity in New Zealand (**Section 54B(1)(a)(ii)**).
   - Whether the Taxpayer was making or intending to make a taxable supply in New Zealand (**Section 54B(1)(d)(i)**).
   - Whether the Taxpayer was making or intending to make a supply in New Zealand to a non-registered person that would be a taxable supply if the Taxpayer was registered under s 51 (**Section 54B(1)(d)(ii)**).
10. There was also a preliminary issue on the onus and standard of proof.

Decisions | Ngā whakatau

11. TCO decided the Taxpayer had not proved that:
   - The Taxpayer was registered for a consumption tax in their country of residence from 1 January 2021 to 31 August 2021.
   - The Taxpayer was carrying on a taxable activity in their country of residence and at a level that would render them liable to be registered for GST if they were carrying out the taxable activity in New Zealand.
   - The Taxpayer was not intending to make taxable supplies in New Zealand.
   - The Taxpayer was not making or intending to make a supply in New Zealand to an unregistered person that would be a taxable supply if the Taxpayer was registered under s 51.

Reasons for decisions | Ngā take mō ngā whakatau

Preliminary Issue | Take tōmua: Onus and standard of proof

12. The onus of proof in civil proceedings[1] is on the taxpayer, except for shortfall penalties for evasion or similar act, or obstruction.[2] The taxpayer must prove that an assessment is wrong, why it is wrong, and by how much it is wrong.[3]

13. The standard of proof in civil proceedings is the balance of probabilities.[4] This standard is met if it is proved that a matter is more probable than not. Whether the Taxpayer discharged the onus of proof is considered in the other issues.

Issue 1 | Take tuatahi: Section 54B(1)(a)(i)

14. To meet the requirements of s 54B(1)(a)(i), the Taxpayer must prove that they are registered for a consumption tax in the country or territory of which they are a resident. The Taxpayer provided a registration certificate which shows that they became registered for a consumption tax on 1 September 2021. The Taxpayer also provided two letters from their overseas accountants. Information contained in the letters shows that the Taxpayer was not registered for the consumption tax before 1 September 2021. Therefore, the available evidence showed that the Taxpayer was not registered for a consumption tax from 1 January 2021 to 31 August 2021. Consequently, the taxpayer did not meet the requirements of s 54B(1)(a)(i) during that time.

Issue 2 | Take tuarua: Section 54B(1)(a)(ii)

15. To meet the requirements of s 54B(1)(a)(ii), the Taxpayer must prove that they are carrying on a taxable activity in a country or territory outside New Zealand at a level that would render the Taxpayer liable to register under s 51(1) if the taxable activity was carried on in New Zealand. In analysing this issue TCO discussed what constitutes a taxable activity and then considered separately the New Zealand activities, the overseas activities and the activities combined.

Taxable activity

16. GST is imposed on taxable supplies of goods and services made by a registered person in the course or furtherance of a taxable activity carried on by the registered person (s 8(1)). There are four requirements that must be satisfied to show there is a taxable activity (s 6(1)(a)):[5]

    - There must be an activity.[6]
    - The activity must be carried on continuously or regularly by a person.[7]
    - The activity must involve, or be intended to involve, the supply of goods and services to another person.[8]
    - The supply or intended supply of goods and services must be made for a consideration.[9]

17. Section 6(3)(a) excludes from the term taxable activity any activity carried on essentially as a private recreational pursuit or hobby while s 6(3)(d) excludes any activity to the extent to which the activity involves the making of exempt supplies.

[1] Challenge proceedings (ie, the proceedings that would follow if this dispute proceeds to the Taxation Review Authority or a court) are civil proceedings.

[2] Section 149A(2) of the Tax Administration Act 1994 (TAA).

[3] *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271 (CA); *Beckham v CIR* (2008) 23 NZTC 22,066 (CA).

[4] Section 149A(1) of the TAA; *Yew v CIR* (1984) 6 NZTC 61,710 (CA); *Birkdale Service Station Ltd v CIR* (1999) 19 NZTC 15,493 (HC); *Case X16* (2005) 22 NZTC 12,216; *Case Y3* (2007) 23 NZTC 13,028.

[5] *Case 14/2016* [2016] NZTRA 14, (2016) 27 NZTC 3-036 at [63]-[70].

[6] *Newman v CIR* (1994) 16 NZTC 11,229 (HC) at 11,233; *CIR v Bayly* (1998) 18 NZTC 14,073 (CA) at 14,078; *CIR v Newman* (1995) 17 NZTC 12,097 (CA) at [32]; *Case 14/2016* at [63].

[7] *Newman* (CA) at 12,100; *Smith v Anderson* (1880) 15 Ch D 247 at 277, 278; *Premier Automatic Ticket Issues Ltd v FCT* (1933) 50 CLR 268 (HCA) at 298; *Case 14/2016* at [67]-[68]; *Wakelin v CIR* (1997) 18 NZTC 13,182 (HC) at 13,185-13,186; *Case N27* (1991) 13 NZTC 3,229 at 3,238-3,239; *Allen Yacht Charters Ltd v CIR* (1994) 16 NZTC 11,270 (HC) at 11,274.

[8] Definition of "supply" in s 5(1); *Databank Systems Ltd v CIR* (1987) 9 NZTC 6,213 (HC) at 6,223; *Pacific Trawling Ltd v Chief Executive of the Ministry of Fisheries* (2005) 22 NZTC 19,204 (HC); *Case S77* (1996) 17 NZTC 7,483; *Case L67* (1989) 11 NZTC 1,391; *Case N27* at 3,238-3,239; *Case 14/2016* at [69].

[9] Definition of "consideration" in s 2(1); *CIR v New Zealand Refining Co Ltd* (1997) 18 NZTC 13,187 (CA) at 12,314.

The New Zealand activities

18. The Taxpayer argued that the New Zealand activities are a taxable activity. In the Commissioner's Notice of Response, CCS argued that the New Zealand activities are excluded from being a taxable activity by s 6(3)(a) and s 6(3)(d) because they are a private recreational pursuit or hobby and they involve the making of exempt supplies. TCO noted that if those arguments had been raised in the Commissioner's Statement of Position, they would not have been relevant to the issue of whether the New Zealand activities are a taxable activity because they are premised on the notion that the Taxpayer is syndicating the horses that they purchased. However, the available evidence indicated that the Taxpayer did not intend to syndicate the horses. Instead, the Taxpayer leased the horses to lessees who will syndicate them.

19. The Taxpayer cited *Case K40* in support of their position.[10] CCS contended that *Case K40* does not support the Taxpayer's position because there are factual differences between the situation in *Case K40* and the Taxpayer's situation. However, TCO decided this was not a sufficient basis upon which a conclusion might be drawn that the New Zealand activities were not a taxable activity.

20. CCS did not raise any other arguments concerning the issue of whether the New Zealand activities were a taxable activity. TCO proceeded on the assumption that the New Zealand activities were a taxable activity without necessarily reaching a final view on this question. This was because there was a degree of conflict in the Taxpayer's position concerning the New Zealand activities. The Taxpayer said that their horses will be leased to private syndicates for syndication purposes but at the same time they cited example 4 in QB 17/04 as reflecting the activities of their business. Example 4 describes a situation involving the syndication of racehorses by the owners of the horses. However, TCO concluded that when determining whether the Taxpayer was entitled to register under s 54B, it was not necessary to reach a final view on the question of whether the New Zealand activities were a taxable activity.

21. The evidence showed that the Taxpayer's horses were to be trained and raced in New Zealand during the terms of the leases. As such, the horses will be located in New Zealand during the time that they are supplied to the lessees. This indicated that the horses will also be in New Zealand when they are sold. Further, the Taxpayer did not argue that the horses would be located outside of New Zealand at that time and there was no evidence to suggest that this might be the case. These circumstances pointed to a conclusion that the supplies of the Taxpayer's horses by way of lease and by way of sale are, or will be, supplies made in New Zealand pursuant to s 8(3). Similarly, the Taxpayer did not argue they were leasing their horses to GST registered persons for the purposes of carrying on their taxable activities or that they intended to sell their horses to GST registered persons for the purposes of carrying on their taxable activities. These circumstances pointed to a conclusion that the supplies of the horses by way of lease and by way of sale will not be treated as supplies made outside New Zealand pursuant to s 8(4).

22. It followed that the New Zealand activities involved supplies made in New Zealand and could not, therefore, be a taxable activity carried on in a country or territory outside New Zealand that would render the Taxpayer liable to register under s 51(1) if it was carried on in New Zealand. Therefore, it is considered that the Taxpayer had not satisfied the onus of proving that the requirements of s 54B(1)(a)(ii) are met in relation to the New Zealand activities to the extent they could have been treated as activities carried out overseas.

The overseas activities

23. The evidence provided by the Taxpayer concerning the overseas activities was not sufficient to establish that the overseas activities were a taxable activity. There was no evidence of the volume, value and dates of the transactions that make up the Taxpayer's income from the overseas activities. Further, although the Taxpayer said that they acted as a bloodstock agent and syndicate manager overseas, no evidence was provided as to the nature and the scale of the activities that the Taxpayer carried on when earning their overseas income or of the resources that they employed when doing so. For these reasons, it was not possible to obtain an accurate picture of the nature, scope, and scale of the overseas activities.

24. The Taxpayer's accountants advised that the Taxpayer earned income from "bloodstock" in the 2020-2021 tax year equivalent to NZ $22,145 (that is, below the $60,000 New Zealand GST registration threshold). The Taxpayer did not dispute this calculation. Further, the Taxpayer did not establish their income from the overseas activities exceeded $60,000 in the 12 month period ending on the last day of the month they sought registration from (i.e., January 2021) or the last day of any subsequent month. This shows that the level of the Taxpayer's activity overseas would not have rendered them liable to register in New Zealand if the activity was a taxable activity and it was carried on in New Zealand. Section 51(1)(a) makes a person liable to register if the total value of

[10] *Case K40* (1988) NZTC 343.

the person's supplies in any month and the 11 preceding months exceeded $60,000. That did not apply here as the value of the Taxpayer's supplies over the 12 months in the 2021 tax year was $22,145 and the Taxpayer did not establish that their income from the overseas activities exceeded $60,000 in any other relevant 12 month period.

Section 51(1)(b) imposes an obligation on a person to register if at the commencement of any month there are reasonable grounds for believing that the total value of the person's supplies during the month and the following 11 months will exceed $60,000. The requirements of s 51(1)(b) were not met in relation to the overseas activities as the $22,145 value of the Taxpayer's supplies in the 2021 tax year do not constitute reasonable grounds for believing that the Taxpayer's supplies would exceed $60,0000 in a subsequent 12-month period.

Composite activity

25. If the New Zealand activities and the overseas activities were treated as a single composite taxable activity, that activity would not meet the requirements of s 54B(1)(a)(ii). This is because the activity includes the New Zealand activities and the New Zealand activities involve the making of supplies in New Zealand. This means that the taxable activity would not meet the requirements of s 54B(1)(a)(ii) because s 54B(1)(a)(ii) can only apply in relation to a taxable activity that is not carried on in New Zealand and which would render the person who carries it on liable to register under s 51(1) if it was carried on in New Zealand.

Issue 3 | Take tuatoru: Section 54B(1)(d)(i)

26. To meet the requirements of s 54B(1)(d)(i) the Taxpayer had to prove that they were not making or intending to make a taxable supply in New Zealand.

27. CCS argued that the supply of the Taxpayer's horses by way of a lease may be taxable supplies even though the lease agreements provided by the Taxpayer did not mention any specific consideration. CCS argued that this may not preclude the supply of the horses under the leases being taxable supplies because the payment of a lessor's costs may constitute consideration moving from lessee to lessor.

Consideration

28. TCO noted that the definition of "taxable supply" in the GSTA does not contain an explicit requirement that a supply must be made for consideration in order for the supply to constitute a taxable supply. However, the definition does require that a supply be made in the course or furtherance of a taxable activity to constitute a taxable supply. The definition of the term "taxable activity" in s 6(1) provides that a taxable activity is an activity that, amongst other things, involves the making of supplies for a consideration.

29. The lease agreements provided by the Taxpayer did not make provision for cash payments from the lessees to the Taxpayer. They did, however, impose obligations on the lessees to pay various costs associated with the Taxpayer's horses including the costs of training and caring for the horses. TCO considered that these obligations come within the definition of "consideration" in s 2 as they are reciprocal obligations that the lessees assume in exchange for the rights and interests that they obtain under the leases. Therefore, TCO considered that CCS's contention that the leasing of the Taxpayer's horses are supplies made for a consideration was correct. Support for this conclusion is found in *Case S72*.[11] In that case, the TRA held that a tenant's obligation to pay rates and insurance on land occupied by the tenant was consideration for the grant of the tenant's interest in the land.

Application

30. TCO noted the Taxpayer was not currently a registered person. Consequently, any supplies that the Taxpayer was making in the course of the New Zealand activities were not taxable supplies. This means that the Taxpayer was not currently making taxable supplies.

31. However, if the Taxpayer were to obtain registration under s 54B, any supplies that they made in the course of the New Zealand activities would be taxable supplies, provided the supplies were made in New Zealand. The available evidence supported a conclusion that the supply of the Taxpayer's horses by way of lease and by way of sale will occur in New Zealand. Therefore, the Taxpayer's intention was to register under s 54B and to make supplies that would be taxable supplies if they were to obtain registration under s 54B. This means that the Taxpayer was intending to make taxable supplies.

[11] *Case S72* (1996) 17 NZTC 7,446.

Issue 4 | Take tuawhā: Section 54B(1)(d)(ii)

32. To meet the requirements of s 54B(1)(d)(ii) the Taxpayer must prove that they were not making or intending to make a supply in New Zealand to an unregistered person that would be a taxable supply if the Taxpayer was registered under s 51. CCS argued that the Taxpayer had not met this requirement. In support of their position, CCS contended that the supplies of the Taxpayer's horses by way of lease and by way of sale may be made to unregistered persons. CCS also argued that their position was consistent with paragraphs 85 and 87-89 of the Commissioner's Interpretation Statement on s 54B.[12]

33. If the Taxpayer was registered under s 51 any supply that the Taxpayer made in New Zealand to an unregistered person in the course of a taxable activity would be a taxable supply. Therefore, the Taxpayer would not meet the requirements of s 54B(1)(d)(ii) if they were intending to make a supply in New Zealand to an unregistered person in the course of the New Zealand activities.

34. The Taxpayer was making or intending to make supplies of their horses by way of lease and by way of sale. The available evidence supported a conclusion that those supplies are supplies that are made, or will be made, in New Zealand. Further, the Taxpayer did not argue that they were going to lease their horses to GST registered persons or that they intended to sell their horses to GST registered persons and there was no evidence to suggest that this was or would be the case.

[12] *IS 21/03 GST — Registration of non-residents under section 54B.*

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