Vol 35 No 11 December 2023

TAX INFORMATION Bulletin

CONTENTS

2 **Interpretation statements**

IS 23/08: Goods and Services Tax – Unit title bodies corporate

IS 23/09: Research and development loss tax credits

IS 23/10: Deductibility of holding costs for land

74 **Technical decision summary**

TDS 23/13: Changing FIF calculation methods

77 **Legal Decision - case summary**

CSUM 23/04: TRA finds disputant to be in a de facto relationship and upholds Commissioner's WfFTC assessments

Inland Revenue
Te Tari Taake

ISSN 1177-620X (Online)

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 **ird.govt.nz/subscription-service/subscription-form** to receive regular email updates when we publish new draft items for comment.

Ref	Draft type	Title	Comment deadline
PUB00443	Question we've been asked	Foreign investment fund (FIF) calculation methods in cases of non-compliance	7 December 2023
PUB00427	Question we've been asked	When is a subdivision project a "taxable activity" for GST purposes?	18 December 2023

GET YOUR TAX INFORMATION BULLETIN ONLINE

The Tax Information Bulletin (TIB) is available online as a PDF at **taxtechnical.ird.govt.nz** (search keywords: Tax Information Bulletin). You can subscribe to receive an email alert when each issue is published. Simply go to **ird.govt.nz/subscription-service/ subscription-form** and complete the subscription form.

FINAL ISSUE FOR 2023

This is the final issue of the Tax Information Bulletin for 2023. The next issue will be in February 2024.

IN SUMMARY

Interpretation statements

IS 23/08: Goods and Services Tax – Unit title bodies corporate 2

This interpretation statement explains how GST applies to transactions between a unit title body corporate, its members and third-party suppliers.

IS 23/09: Research and development loss tax credits 26

This interpretation statement provides guidance on who is eligible for research and development (R&D) loss tax credits.

IS 23/10: Deductibility of holding costs for land 49

This interpretation statement considers the deductibility of holding costs for land and whether the land being taxed on sale is relevant to deductibility. Holding costs are expenses incurred in relation to the ownership of land, such as interest, rates, property insurance, and repairs and maintenance and body corporate levies (provided they are revenue expenses). Holding costs do not include capital improvement costs or expenses that relate only to the use of land.

Technical decision summary

TDS 23/13: Changing FIF calculation methods 74

Changing FIF calculation methods; fair dividend rate method; comparative value method.

Legal Decision - case summary

CSUM 23/04: TRA finds disputant to be in a de facto relationship and upholds Commissioner's WfFTC assessments 77

The Taxation Review Authority (the TRA) upheld the Commissioner's assessments of the disputant's entitlement to Working for Families Tax Credits (WfFTC) at nil for each of the income years in dispute. The Commissioner considered that the disputant was in a de facto relationship and her partner's income should have been included as part of her family scheme income for WfFTC purposes.

INTERPRETATION STATEMENTS

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

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

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

Some interpretation statements may be accompanied by a fact sheet summarising and explaining the main points. Any fact sheet should be read alongside its corresponding interpretation statement to completely understand the guidance. Fact sheets are not binding on the Commissioner. Check **taxtechnical.ird.govt.nz/publications** for any fact sheets accompanying an interpretation statement.

IS 23/08: Goods and Services Tax – Unit title bodies corporate

Issued | Tukuna: 24 October 2023

This interpretation statement explains how GST applies to transactions between a unit title body corporate, its members and third-party suppliers.

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

Summary | Whakarāpopoto

1. This interpretation statement explains the consequences of registering for GST for a unit title body corporate (UTBC) and the GST treatment of transactions with its members and third parties.
2. Under both the Unit Titles Act 2010 (UTA 2010) and the GST Act, a UTBC is a separate legal person to its members. The GST Act includes specific rules that apply to UTBCs.[1] From a GST perspective, a UTBC is treated as making supplies to its members for consideration (in the form of levies). It also transacts with third parties receiving supplies and providing consideration. A UTBC can generally choose whether to register for GST.
3. While a UTBC will have a taxable activity, it will generally not become liable to register for GST. This is because the value of supplies it makes to its members is not counted towards the $60,000 GST registration threshold. However, a UTBC can voluntarily register for GST. If it chooses to register, it must make a one-off output tax adjustment when it registers based on the money and investments it holds. A GST-registered UTBC needs to account for output tax on supplies to its members but can generally claim input tax deductions on transactions with third parties.
4. For UTBCs that are registered for GST, this interpretation statement sets outs the GST treatment of:
    - goods and services a UTBC acquires before registration;
    - services that a member supplies to a UTBC;
    - a UTBC's supply of manager's accommodation;
    - a UTBC's payments of ground rent and levies it charges to members for ground rent; and
    - one-off payments a UTBC receives, such as settlement payments, court awards, insurance payments and payments from the Ministry of Business, Innovation and Employment (MBIE) under the Leaky Homes Financial Assistance Package (FAP).
5. For these transactions, the Commissioner considers the GST treatment is as follows:
    - A UTBC cannot claim input tax deductions on goods and services acquired before registration, but may claim a deduction under s 21F when pre-registration goods are disposed of, or deemed to be disposed of under s 5(3) on deregistration.
    - Supplies of services by a member to a UTBC must be accounted for separately for GST purposes from a UTBC's supplies to that member (for which levies are consideration) even if the consideration for those supplies is set off.

1 The Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016 implemented these rules.

- Whether a UTBC's use of an apartment to supply manager's accommodation will be an exempt supply under s 14(1)(c) of the GST Act depends on whether the manager lives in the apartment as their main residence and whether they have quiet enjoyment, as that term is used in s 38 of the Residential Tenancies Act 1986 (the RTA).
- A landowner's supply of leasehold land by way of rental (being the land on which the unit title development / apartment complex is on) to a UTBC will be an exempt supply to the extent that land is used for the principal purpose of accommodation in a dwelling (s 14(1)(ca)). This is calculated by determining which units are and which are not used for this principal purpose:
  - Under s 5(8A), levies a UTBC raises to pay for ground rent that relate to units used for the principal purpose of accommodation in a dwelling will not be "consideration for taxable supplies". As a result, these levies are not subject to GST.
  - Levies a UTBC raises to pay for ground rent that relate to units **not** used for the principal purpose of accommodation in a dwelling will be consideration for taxable supplies. As a result, these levies are subject to GST.
- Where a UTBC receives court awards and out-of-court settlements, GST consequences may apply if the payment is sufficiently connected to a supply such that it is consideration (or modification of consideration) for that supply. For an explanation of the Commissioner's position on the GST treatment of settlements and out-of-court settlements, see **IS 23/07: GST - Court awards and out-of-court settlements.**[2]
- Typically, where a registered UTBC receives an insurance payment, the UTBC will have an output tax liability based on the amount it receives (s 5(13)).
- MBIE FAP payments are treated as consideration for a supply of goods and services under s 5(6D). A GST-registered UTBC that receives an MBIE FAP payment will need to include this amount in its GST return for the period. Where an unregistered UTBC receives an MBIE FAP payment, that payment does not make the UTBC liable to register for GST.

Introduction | Whakataki

6. A unit title development is a type of subdivision of land that enables different people to own a defined part of a building. This form of subdivision is typical for apartment complexes. A UTBC is automatically created when a unit title development is set up under the UTA 2010. A UTBC is made up of the unit owners (or members) of a unit title development and is responsible for managing and maintaining the building and providing other services such as arranging building insurance. A UTBC levies its members to pay for the expenses it incurs in meeting its responsibilities.
7. After the High Court decision in *Taupo Ika Nui Body Corporate v CIR*,[3] there was some uncertainty as to whether a UTBC could register for GST. Rules enacted in 2016 clarified the law and provided UTBCs with the option to register for GST. These rules also preserved the position UTBCs had historically taken, meaning UTBCs can continue to be registered or unregistered as they choose.
8. This interpretation statement provides guidance on the GST obligations of a UTBC if it chooses to register for GST. It sets out:
   - the legal nature of UTBCs (from [9]);
   - an overview of GST in the context of a unit title development (from [20]);
   - the registration process for a UTBC choosing to register for GST (from [31]); and
   - the GST treatment of specific transactions affecting UTBCs, including the GST treatment of:
     - goods and services a UTBC acquires before registration (from [72]);
     - services that a member supplies to a UTBC (from [75]);
     - manager's accommodation that a UTBC supplies (from [77]);
     - ground rental payments for a unit title development on leasehold land (from [103]); and
     - receiving one-off payments, notably court awards, settlement payments, insurance payments and payments from the Ministry of Business, Innovation and Employment under the Leaky Homes Financial Assistance Package (from [135]).

2 *Tax Information Bulletin* Vol 35, No 7 (August 2023): 72.

3 (1997) 18 NZTC 13,147.

The legal nature of UTBCs

9. A UTBC is a legal entity created under the UTA 2010 when multiple owners (unit owners or members) have unit title properties in an apartment building or similar complex (a unit title development). The UTBC is made up of all unit owners and provides a way for individual owners to act together for their common and shared interests.
10. The UTA 2010 sets out the powers and duties of the UTBC and the rights and responsibilities of members. A UTBC will nominate a chairperson and typically establish a body corporate committee among the owners. These people will usually handle the administrative and governance functions as well as the day-to-day operations of the UTBC. However, the UTBC may also employ or engage a body corporate manager to help with these matters.
11. Under the UTA 2010, the UTBC is responsible for managing, maintaining, repairing and organising insurance for the building and the common areas, paying ground rent if the unit title development is on leasehold land, as well as enforcing the body corporate operational rules. Members/owners are required to follow those rules and pay levies to the UTBC.

Property rights and obligations in a unit title development

12. Apartment buildings (or unit title developments) typically consist of three main areas:
    - principal units;
    - accessory units; and
    - common property.
13. In the context of an apartment building, each apartment will typically be a "principal unit". A unit title development may also include other units (eg for car parks and storage lockers). In some unit title developments, there are accessory units that "belong with" a principal unit. In other cases, car parks can be principal units and owned by persons who do not own an apartment.
14. Everything in a unit title development that is not within a unit is the common property. This could include the foyer or reception area, lifts, stairwells and any external areas such as tennis courts or swimming pools. The common property is owned by the UTBC.[4]
15. The UTBC levies each member using either the member's ownership interest or utility interest based on the units they own and the purpose of the levy:[5]
    - Ownership interest is based on the value of the unit relative to other units in the unit title development. It is used to calculate levies for the capital improvement fund.[6]
    - By default, the utility interest is the same as the ownership interest. The UTBC uses it to calculate levies for the operating account, long-term maintenance fund and any contingency fund.[7] It can assign a different utility interest to different units to reflect their varying costs.[8] The differences in interest can target a particular service or amenity. For instance, a UTBC may assign higher utility interest to apartments on the top floor of a development to reflect additional costs of plumbing and lifts associated with those apartments.

Relationship between a UTBC and its members

16. Because a UTBC looks like a mutual funding arrangement where funds are pooled and used to pay common expenses, it is sometimes suggested that a UTBC acts as agent for its members.
17. **IS 21/01: GST and agency**[9] sets out the Commissioner's view on agency. In summary, an agency relationship requires two features:
    - Authority: The agent must be authorised to act on behalf of the principal to create or affect the legal relations between the principal and a third party, for the relevant supply.
    - Consent: Both the agent and the principal must have consented to the authority that is conferred on the agent.

4 Section 54(1) of the UTA 2010.
5 Section 121 of the UTA 2010.
6 Section 38 of the UTA 2010.
7 Section 39 of the UTA 2010.
8 Section 41 of the UTA 2010.
9 *Tax Information Bulletin* Vol 33, No 2 (March 2021): 21.

18. The UTA 2010 imposes obligations on a UTBC that are inconsistent with the UTBC acting as the agent of its members:
    - A UTBC is a separate legal person with the powers of a natural person (s 77 of the UTA 2010). However, it is only able to act for the purposes of performing its duties or exercising its powers (s 78 of the UTA 2010).
    - A UTBC's duties and powers are set out in the UTA 2010 and listed in s 84. These duties are obligations on the UTBC itself. Although a UTBC may need to engage a third party to comply with these obligations (eg to engage a cleaning service for the common property), the UTBC is ultimately responsible for ensuring they are done.
19. As a result, the UTBC typically acts as principal in its dealings. Specific provisions in the GST Act (ss 5(8A) and 21HC) operate consistently with this conclusion.

Historical agency supplies

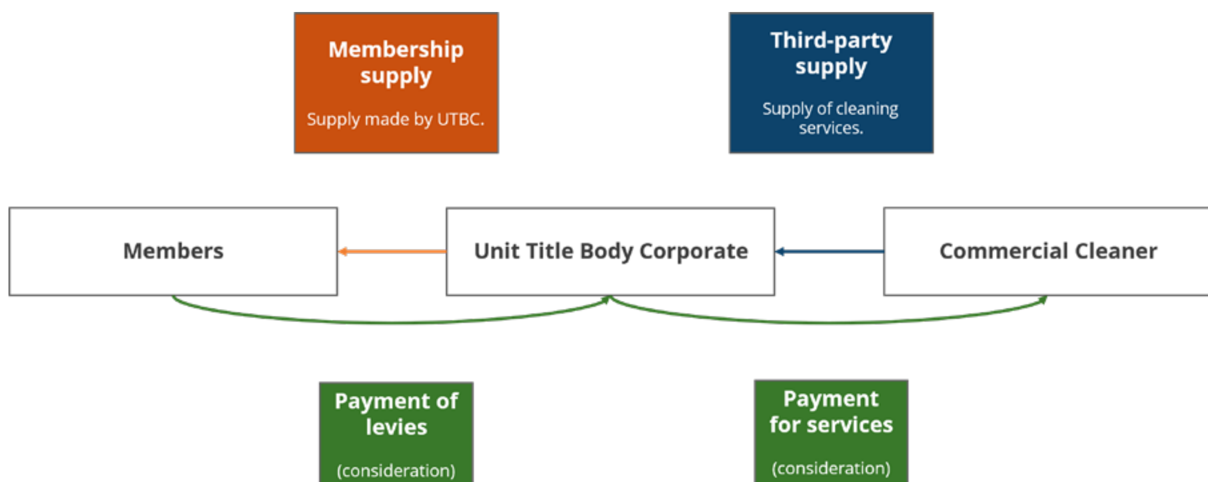
Historically, there was some confusion as to whether or not a UTBC acted as an agent for its members. This confusion led some people to apply the GST Act as if the UTBC was an agent of its members. After this position was clarified in 2014, in 2016 the law was changed to confirm the correct position that a UTBC is not an agent of its members. Given this historical uncertainty, the 2016 changes included a savings provision (set out in ss 20(3)(hc) and 21HC) to preserve positions taken in periods ending between 1 November 2010 and 3 November 2015 (including taxable periods which include 3 November 2015).

Essentially the savings provision allowed members of unregistered UTBCs to claim an input tax deduction for their portion of supplies acquired from registered third parties. This applies in situations where the member acquired the goods or services to make taxable supplies in their taxable activity. As noted above, this only applied between 2010 and 2015 and so is of historical interest only.

Overview of GST for a unit title development

20. To understand how GST applies to a UTBC, it is useful to first consider the two main transactions that a UTBC is typically involved in:
    - The first relates to the UTBC's supply of services to members for levies that it is treated as making under the GST Act.
    - The second involves the UTBC's purchase of supplies from third parties.
21. In this interpretation statement, we refer to these transactions as:
    - **membership supplies** – supplies a **UTBC** is treated as making **to its members**; and,
    - **third-party supplies** – supplies **third parties** make **to a UTBC**.
22. Under s 5(8A) of the GST Act, all levy payments from members to a UTBC are consideration for taxable supplies unless they meet certain criteria (discussed from [103]).
23. Figure 1 gives an example of the membership supply and third-party supply in the context of a levy payment to pay for cleaning services from a third-party contractor.

Figure 1: Supplies of cleaning services



24. Figure 1 shows the two distinct supplies are:
    - a deemed **membership supply** that the UTBC makes to its members for which the levies are consideration; and
    - a **third-party supply** in relation to the commercial cleaner's supply of cleaning services to the UTBC.

Taxable activity

25. Typically, a UTBC will have a taxable activity (meaning it can register for GST) because:
    - a UTBC has an activity (relating to performing its duties under the UTA 2010) and it will carry on this activity continuously or regularly; and
    - s 5(8A) of the GST Act treats levies and payments from members to the UTBC as consideration for supplies a UTBC makes.

Liability to register for GST

26. A person making taxable supplies in the course or furtherance of a taxable activity is liable to register for GST under s 51 if the value of its supplies exceeds $60,000 in any 12-month period. A UTBC will generally not be liable to register because s 51(1B) excludes the value of supplies a UTBC makes to its members in calculating whether it meets the $60,000 threshold. Given this, a UTBC will generally be able to register for GST but will not be liable to register. This means that registration for a UTBC is voluntary unless it makes over $60,000 of supplies to third parties.
27. Some unregistered UTBCs may make supplies to third parties. These could include leasing car parks on the common property or providing advertising space on the common property (eg, the exterior of the building) to a business. These UTBCs should be aware of the value of these supplies, as they could cause the UTBC to be required to register for GST, despite s 51(1B).

Effect of registering for GST

28. When a UTBC registers for GST it must file a GST return for each return period. The GST charged on a registered UTBC's taxable supplies is referred to as "output tax". GST that is charged on goods and services that a registered UTBC acquires is called "input tax". Generally, a registered UTBC may claim input tax deductions.[10] A registered UTBC will have to account for GST output tax on its membership supplies and any other supplies it makes. The amount of tax payable is calculated by deducting input tax on third-party supplies from the amount of output tax.
29. A GST registered member of a GST registered UTBC may use their unit in their taxable activity (for instance, if the unit is a café). In this case the member may be able to claim input tax deductions in relation to the membership supplies (for which levies are consideration). The extent to which an input tax deduction is available in relation to the membership supply will typically depend on whether the unit is used for the principal purpose of making taxable supplies. Remember, a GST registered member can only claim input tax deductions in relation to the membership supply if the UTBC is also registered for GST.
30. Against this background of how GST can affect UTBCs, the next section deals with a UTBC's decision as to whether to register for GST.

Registering for GST

31. This section explains the decisions and process for a UTBC that is thinking about whether to register for GST. If your concern is with a UTBC that is already registered for GST, you can skip this section and focus on the GST treatment of specific transactions from [70].
32. The registration process for UTBCs is similar to the registration process for any other person. However, the following specific rules apply only to UTBCs when they register for GST:
    - A UTBC can only voluntarily register with effect from a date after the date it applies for registration (s 51(5B)).
    - When a UTBC registers for GST, it must make an output tax adjustment for a deemed supply equal to the total value held of money, and of assets that are not common property and that the UTBC received as exempt supplies.
    - A UTBC must stay registered for at least 4 years before it can voluntarily deregister (s 52(8)).
33. After summarising the general registration requirements, we discuss how these specific rules operate.

10 Either because the goods and services are used for, or are intended to be used in, making taxable supplies (s 20(3C)) or because the goods and services are acquired for the principal purpose of making taxable supplies (s 20(3CC)).

Compulsory and voluntary registration

34. The GST Act provides for both compulsory and voluntary registration. Section 51(1)(a)–(b) sets out the main provisions on compulsory registration. These explain that a person who has a taxable activity must register for GST when the total value of their supplies made in a year is over $60,000 or it is apparent in a month that they will meet the threshold in the next 11 months. For UTBCs, there are two important exclusions to the $60,000 threshold. We address these below.

Exclusion for member supplies

35. Typically, a UTBC will not meet the $60,000 threshold, even if the value of its supplies to members would exceed the threshold. This is because s 51(1B) excludes the value of supplies that a UTBC makes to its members from the $60,000 threshold:

> **51 Persons making supplies in course of taxable activity to be registered**
>
> ...
>
> (1B) For the purposes of determining under subsection (1) the liability of a unit title body corporate to be registered, the value of a supply of a service made by the body corporate to a member is not included in the total value of supplies made in New Zealand by the body corporate.

36. As a result, s 51(1B) gives most UTBCs the choice of whether to register for GST or not; it is voluntary. Unless the UTBC is making supplies to people who are not members that have a total value of over $60,000, it will not become liable for registration.

Proviso to s 51(1)(a)

37. If a UTBC makes supplies to people who are not members that have a total value of over $60,000 it still may not become liable for registration. This is because the proviso to s 51(1)(a) may apply:

> **51 Persons making supplies in course of taxable activity to be registered**
>
> (1) Subject to this Act, every person who, on or after 1 October 1986, carries on any taxable activity and is not registered, becomes liable to be registered—
>
> (a) at the end of any month where the total value of supplies made in New Zealand in that month and the 11 months immediately preceding that month in the course of carrying on all taxable activities has exceeded $60,000 (or such larger amount as the Governor-General may, from time to time, by Order in Council declare (see subsection (8)):
>
> **provided that a person does not become liable to be registered by virtue of this paragraph where the Commissioner is satisfied that the value of those supplies in the period of 12 months beginning on the day after the last day of the period referred to in the said paragraph will not exceed that amount:**
>
> [Emphasis added]

38. The effect of this provision is that if a UTBC makes a one-off supply (or is treated as having made a one-off supply) that would take it over the $60,000 registration threshold, it is not liable to register if the Commissioner is satisfied the UTBC is not expected to exceed the threshold in the next 12 months. Example | Tauira 1 demonstrates this situation.

Example | Tauira 1: Deemed supply by an unregistered UTBC

Body Corporate Number 100,000 is an unregistered UTBC. Although it usually collects $75,000 from members as levies each year, it is not liable to register for GST because supplies that UTBCs make to members are not included in the $60,000 threshold. Usually the UTBC does not make any supplies to third parties.

One year, Body Corporate Number 100,000 receives a payment of $100,000 from the Ministry of Business, Innovation and Employment under the Leaky Homes Financial Assistance Package. This $100,000 is a payment in the nature of a grant or subsidy made on behalf of the Crown, which is treated as being consideration for a supply of goods and services in the course or furtherance of the UTBC's taxable activity under s 5(6D) (discussed from [145]).

However, even though Body Corporate Number 100,000 met the threshold in this year, the Commissioner considers that it is not liable to register. This is because under s 51(1)(a), the Commissioner considers that the value of the supplies in the 12 months after the month in which the UTBC received the payment will not go over the $60,000 threshold as it generally only makes supplies that are subject to s 51(1B).

Timing of voluntary registration

39. If a person has a taxable activity and does not meet the threshold, they can voluntarily register for GST under s 51(3) of the GST Act. As a UTBC will have a taxable activity, it can choose to voluntarily register under this provision.
40. If a UTBC applies for voluntary registration, it can only register with effect from a date **after** the application date – see s 51(5B):

> **51 Persons making supplies in course of taxable activity to be registered**
>
> (...)
>
> (5B) A unit title body corporate that is registered under this Act as a result of an application under subsection (3) made on a date (the application date) on or after the date of introduction of the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Bill must be registered with effect from a date after the application date.

Taxable periods and accounting basis

41. If a UTBC decides to register for GST it will need to determine its taxable period and its accounting basis. A registered person pays GST to Inland Revenue periodically, based on their taxable period. Under s 15, the default taxable period is a 2-month period, but a UTBC also has the option of filing monthly or, if its taxable supplies are no more than $500,000 in a 12-month period, of filing 6-monthly.
42. Where a UTBC registers for GST it will also need to select an accounting basis. The accounting basis determines which period your output tax liabilities or input tax deductions relate to. The two main choices are the invoice basis and payments basis. Under the invoice basis output tax is payable at the time of supply. This is generally the earlier of the time when the person has provided an invoice (ie, taxable supply information) for the supply or when they receive any payment. Under the payments basis, the person accounts for GST output tax once they have received payment for the supply. Example | Tauira 2 illustrates the two options.

Example | Tauira 2: Recognition of time of supply

> Body Corporate Number 200,000 is a registered UTBC with a unit title development in Taranaki consisting of 15 principal units. It registered for GST on a payments basis, and has a 2-monthly taxable period and a March balance date.
>
> On 1 May the UTBC levies its members by providing taxable supply information (previously a "tax invoice") requesting payment by the end of the month (31 May). Five members pay late, in June.
>
> As the UTBC is registered on a payments basis, it will account for the sum of the 10 levies it received in the April–May period. It will then recognise the sum of the five late payments the next period (June–July).
>
> If the UTBC had registered on an invoice basis, it would account for GST on the total amount (the sum of all 15 levies) in the April–May taxable period.

Output tax liability on registration

43. Where a UTBC decides to register for GST, s 5(8AB) requires the UTBC to make a oneoff output tax adjustment. Essentially, the section imposes an output tax liability on the UTBC based on the money and investments the UTBC holds on the day it is registered. It does this by treating a UTBC as receiving consideration for a service supplied on the day it becomes registered equal to the total value it holds of money, and of assets (excluding the common property) that it receives as exempt supplies:

> **5 Meaning of term supply**
>
> ...
>
> (8AB) For the purposes of this Act, a unit title body corporate is treated as receiving, on the day when the body corporate becomes a registered person (the registration day), consideration for a service, supplied on the registration day by the body corporate in the course of its taxable activity, equal in value to the total value held by the body corporate on the registration day of money and of assets that are not common property and were received by the body corporate as exempt supplies.

44. This rule is to prevent a UTBC from accumulating levies from members without returning output tax before it registers for GST and then claiming input tax deductions when it spends those funds after registration.

The deemed supply under s 5(8AB)

45. As noted at [43], under s 5(8AB) the UTBC is treated as receiving consideration for a supply of services in the course or furtherance of its taxable activity equal in value to:

> the total value held by the body corporate on the registration day of money and of assets that are not common property and were received by the body corporate as exempt supplies.

46. For this reason, on the day it registers a UTBC will need to determine the "total value held" of:
    - money; and
    - assets that are not common property and that the body corporate received as exempt supplies (typically this would be financial investments).

47. Once the UTBC has determined the "total value held" of the money and assets, it will include this amount in its first GST return.

48. To determine the "total value held", a UTBC will need to understand:
    - the meaning of the word "money" (see [49]);
    - the meaning of the words "assets that are not common property and were received by the body corporate as exempt supplies" (relevant assets) (see from [50]); and
    - the scope of the words "total value held" (see from [60]).

Money

49. Section 2 of the GST Act defines money to include bank notes, postal notes, money orders, promissory notes and bills of exchange. The amounts of money within the bank account(s) established by the UTBC for the funds it is required to maintain under ss 115–119 of the UTA 2010 would typically be "money" that is intended to be included in s 5(8AB).

Assets

50. The GST Act does not define assets. The use of the word "assets" in addition to the word "money" in s 5(8AB) indicates that, for the purposes of this provision, "assets" has a meaning that is distinct from "money". (Similarly the definitions of both "goods" and "services" in s 2 exclude "money".)

51. Of relevance to this discussion, the *Oxford English Dictionary* defines an "asset" as "an item of value owned".[11] Further, the External Reporting Board (XRB) defines an "asset" as a present economic resource that the entity controls as a result of past events.[12]

52. From these definitions, at first glance the meaning of "asset" is broad. However, for the purposes of s 5(8AB), it is significantly limited because it:
    - does not include the common property; and
    - will only include things that the body corporate receives as an exempt supply.

Exclusion of assets that are common property

53. The GST Act defines common property as having the same meaning as in the UTA 2010. The UTA 2010 definition (s 5(1)) is:

> **common property** means—
> (a) all the land and associated fixtures that are part of the unit title development but are not contained in a principal unit, accessory unit, or future development unit; and
> (b) in the case of a subsidiary unit title development, means that part of the principal unit subdivided to create the subsidiary unit title development that is not contained in a principal unit, accessory unit, or future development unit.

11 *Oxford English Dictionary* (online ed, 3rd ed, Oxford University Press, 2008, OED Online Version June 2022, accessed 21 July 2022).

12 *For-Profit Standards Glossary 2022*. The XRB draws its definitions from New Zealand Equivalent to International Accounting Standard (NZ IAS) 38.8 and 2018 New Zealand Conceptual Framework (CF) 4.3.

54. Common property means all of the land and fixtures that are part of the unit title development but not contained in a principal or accessory unit.
55. Based on this definition, common property of a UTBC includes the land, the apartment building (except for the spaces that comprise the units) and anything affixed to the building. In this context, a fixture such as a veranda that is attached to the exterior of the building and accessible through the common property would also form part of the common property, because it is an associated fixture.[13] Such fixtures can be distinguished from items like pot plants and chairs that the UTBC purchases for use in the common area. These would not be fixtures and would not be part of the "common property" even though the UTBC owns them.
56. As a result, the land, building and anything affixed to the building would be excluded from the s 5(8AB) calculation as common property.

Inclusion of assets received as an exempt supply

57. Section 14 of the GST Act sets out exempt supplies. In the context of a unit title development, the main assets a UTBC may receive as exempt supplies would be supplies of financial services. This is because a UTBC may only act for the purpose of performing its duties or exercising its powers (s 78 of the UTA 2010). Most other exempt supplies involve transactions that would be outside the scope of what a UTBC can do.
58. Section 3 of the GST Act defines the term "financial services". It is a detailed definition covering a wide range of different activities. Many of the activities within the definition of financial services relate to investments, including creating and assigning a debt security (ie, loans) and transferring ownership of shares in a company. Under s 130 of the UTA 2010, a UTBC can borrow money and invest any money in any investment authorised by law for the investment of trust funds.
59. As a result, the most likely examples of relevant assets will be bonds, shares or other financial investments. Other assets such as pot plants and chairs would not be included because, while they are not part of the "common property", the UTBC would not have "received [them] as an exempt supply".

The "total value held" of money and relevant assets

60. In most cases, a UTBC will find it easy to determine the "total value held" of money and relevant assets on the day it registers for GST. This is because its money and relevant assets will clearly be within its direct possession. However, in some cases a UTBC may place money and relevant assets outside its direct possession but still have control over them.
61. The Commissioner considers the scope of the words "total value held" in s 5(8AB) is broad. This means money or relevant assets that a UTBC provides to a third party to facilitate a transaction or as security for a transaction and held by that third party on registration day will generally remain part of the "total value held" for the purposes of s 5(8AB).
62. Where a third party holds money to facilitate a transaction, it would likely hold this money as a "stakeholder". **IS 10/03: GST: Time of supply – Payments of deposits, including to a stakeholder**[14] discusses when a person may be a stakeholder and how this impacts the time of supply. Essentially, where a UTBC has paid money to a person as stakeholder and requires that person to hold that money until a defined event takes place, the UTBC has not paid the amount to the supplier and the time of supply has not occurred because the UTBC has not yet made the payment. If the defined event has taken place, the third party would hold the money not as a "stakeholder", but rather as agent for the recipient. In this case, the money would not be part of the "total value held" as the UTBC no longer has control over this money.
63. This outcome is consistent with the purpose of s 5(8AB) and the context of the GST Act. A purpose of s 5(8AB) is to prevent a UTBC from using its ability to optionally register for GST to gain a tax advantage. A broad interpretation of s 5(8AB) prevents a UTBC from obtaining a benefit by putting money or relevant assets outside the scope of the provision.

Effect of "total value held" on money and assets

64. The following examples demonstrate how s 5(8AB) applies in different contexts:
    - Example | Tauira 3 provides a simple illustration of the money and assets covered by s 5(8AB).
    - Example | Tauira 4 provides a more detailed illustration of s 5(8AB), highlighting how to treat money a stakeholder holds and which assets are relevant assets.

13 *Body Corporate 198900 v Bhana Apartments Ltd* [2015] NZHC 1620, at [35].

14 *Tax Information Bulletin* Vol 22, No 6 (July 2010): 7.

Example | Tauira 3: Money and assets

Body Corporate Number 300,000 voluntarily applies to register on 8 November 2022, with effect from 1 December 2022.

On 1 December 2022, the UTBC has $10,000 in its operating account and $25,000 in its long-term maintenance fund. It also holds an investment in shares listed on the NZX that have a market value of $11,000.

The effect of s 5(8AB) is that the UTBC is deemed to make a supply for consideration equal to $46,000 on the date of registration and is required to return output tax of $6,000. This is 3/23 of the total value of money and exempt assets (excluding common property) it held on the day it registered for GST.

The UTBC will include $46,000 in its first GST return.

Example | Tauira 4: Deemed supply on registration

Body Corporate Number 400,000 is an unregistered UTBC consisting of 25 apartments (principal units). Alan, a GST-registered owner of one of the apartments in the unit title development, suggested to Steve, the chairperson of the UTBC, that it should register for GST.

Steve, not knowing much about GST, discusses the matter with the body corporate committee and decides to raise it at the next AGM. At the AGM members agree that the UTBC should register as soon as possible, so Steve applies for registration on 15 June 2022, effective on 1 July 2022.

In making the calculation required under s 5(8AB), Steve notes that the body corporate holds:

- $90,000 in money from the various funds;
- $25,000 of shares and other investments; and
- assets worth $2,600, which is the total value of tables, chairs and pot plants purchased for the ground floor common area.

Steve also notes that the UTBC had contracted with a builder to re-model the common area on the ground floor. As this is a substantial amount of work, the UTBC and the builder agreed that funds would be transferred to a solicitor until various stages of construction have been completed. The UTBC had transferred $30,000 to its solicitor for this work.

Under the terms of the agreement, funds must be transferred to the builder on successful completion of various stages of the construction. On 29 June 2022 (2 days before registration), the UTBC and the builder agreed that the first stage of construction was complete. As a result, the solicitor should have transferred $6,000 (as the agreed amount for the first stage of construction) to the builder. Steve raised this with the solicitor, who noted that the $6,000 was paid out of the account on 3 July 2022.

The s 5(8AB) calculation

Steve must include the $90,000 in money held in various accounts. He must also include the shares and other investments with a value of $25,000.

Steve does not need to include the assets worth $2,600 as the UTBC did not receive them as exempt supplies and they are not associated fixtures so do not form part of the common property. The value of the common property itself is not included.

Steve needs to include $24,000 of the funds the solicitor held because they held these funds as stakeholder. The transaction to which these funds relate has not occurred for GST purposes. From 29 June, the solicitor held the $6,000 as agent of the builder and paid it to the builder on 3 July. The solicitor held only $24,000 as stakeholder on the registration day of 1 July 2022.

Steve now adds up the amounts:

$90,000 + $25,000 + $24,000 = $139,000

He then multiplies this amount by the tax fraction to work out the output tax liability on registration:

$139,000 × (3/23) = $18,130

Body Corporate Number 400,000 must include $139,000 in its first return due to s 5(8AB) of the GST Act.

It must also include the total value of other supplies made (eg, levies raised) during the period but will be able to claim an input tax deduction on supplies it received during the same period.

No taxable supply information need be issued

65. After registration, a UTBC will start issuing taxable supply information (previously a "tax invoice") for its member supplies. However, it does not issue taxable supply information for the deemed supply under s 5(8AB). Because no person receives this supply, no person can claim an input tax deduction on it.

Deregistration

66. Ordinarily, a registered person who is carrying on a taxable activity will cease to be liable to be registered when the Commissioner is satisfied that the value of their taxable supplies will be under the threshold over the next 12 months (s 52(1)). In this case a person can voluntarily deregister for GST while continuing their taxable activity, after making a deregistration adjustment (ss 5(3) and 52(2)). A UTBC does not make a deregistration adjustment under s 5(3) in relation to the value of the common property. This is because the common property is treated as having a zero value for these purposes (s 10(7A)).

67. As the value of a UTBC's supplies to its members is not included when calculating whether it is over the threshold, a UTBC will typically not become liable for registration. As a result, it would also be able to voluntarily deregister in most circumstances.

68. However, specific rules limit a UTBC's ability to cancel its registration:

- If a UTBC was registered as at 26 February 2015, the cancellation can only take effect on a date after it applies for cancellation (s 52(8)).
- If a UTBC is registered after 26 February 2015, the cancellation must take effect on the later of the date the UTBC applied for cancellation, and 4 years after registration date (s 52(9)). In essence, a UTBC must remain registered for at least 4 years.

69. If a UTBC ceases to have a taxable activity (ie, the unit plan is cancelled), registration would typically be cancelled with effect from the day the unit plan is cancelled.

Treatment of specific transactions for UTBCs

70. This section sets out the GST treatment of specific transactions involving registered UTBCs. Those UTBCs that are unregistered and are not planning to register do not need to review this section in detail. However, understanding the GST treatment may help a UTBC to decide whether to register, taking account of what the consequences are for registered and unregistered members.

71. The transactions we consider are:

- goods and services a UTBC acquires before registration;
- services that a member supplies to the UTBC;
- the supply of manager's accommodation;
- ground rent; and
- receiving one-off payments.

Goods and services a UTBC acquires before registration

72. Ordinarily, when a person registers for GST after operating their taxable activity while unregistered, they will have accumulated goods and services. These goods and services may have been subject to GST but, because the person was not registered, they were unable to claim an input tax deduction.

73. Under s 21B of the GST Act, a person can claim an input tax deduction in relation to the goods and services they acquired before registration that were charged with GST. However, this provision does not apply to a UTBC (s 21B(1)(a)). As a result, a UTBC is unable to claim input tax deductions for goods and services it acquired before it registered.
74. Section 21F will generally allow a UTBC to claim an input tax deduction when it disposes of these goods or services in the course or furtherance of its taxable activity or when it is deemed to do so on deregistration under s 5(3). Typically, the deduction available on disposal (or deemed disposal) under s 21F will match the output tax obligation on disposal (or deemed disposal). As discussed at [66], a UTBC does not make a deregistration adjustment under s 5(3) in relation to the value of the common property, but would make a deregistration adjustment in relation to the value of its other goods and services.

Services that a member supplies to a UTBC

75. In some cases, a registered member may provide services to a UTBC. Where the member simply charges and issues taxable supply information to the UTBC for the full value of the supply as part of normal business practice, no issue exists. However, sometimes it is suggested that the amount the UTBC owes should be offset against any levies it charges to the member.
76. The approach that the UTBC and the member agree on to satisfy the payment for these services does not change the correct accounting for GST purposes. The correct accounting for GST purposes is that there are two supplies. One supply is the services the member supplies to the UTBC, which is likely charged with GST at the standard rate under s 8(1) if the member is GST registered. The second supply is the UTBC's deemed supply to the member under s 5(8A). Both these supplies require the supplier(s) to account for GST output tax and may give rise to an input tax deduction for the recipient(s). Example | Tauira 5 illustrates the tax treatment in these circumstances.

Example | Tauira 5: Accounting for GST on supplies from members

Manu is a GST-registered electrician. He owns and lives in an apartment in Sunnydale Apartments, a unit title development in Tauranga. Manu operates his business from an office located in a different part of the city.

The UTBC of Sunnydale Apartments is GST registered and files its returns 2monthly on an invoice basis.

One day the chairperson of the UTBC calls Manu to ask whether he could fix a few faulty electrical sockets and light fixtures in the common property of the development.

Manu agrees, completes the work and issues taxable supply information to the UTBC on 20 June 2023 for $345 ($300 for the services plus GST) for the electrical services.

On 5 July 2023 (within the same GST period), the UTBC levies each of its members $920 (including GST). Given it is yet to pay Manu for his services, the UTBC and Manu agree to offset Manu's levy costs against the amount the UTBC owes for Manu's electrical services. As a result of this offset, Manu pays $575 (ie, $920 less $345) to the UTBC. (Other members pay $920 including GST.)

Both the UTBC and Manu will need to properly account for GST on the supplies in these ways:

- The UTBC will have an output tax liability of $120 on the membership supply to Manu.
- The UTBC will have an input tax deduction of $45 on its spending on electrical services.
- Manu will have an output tax liability of $45 in relation to his supply of electrical services to the UTBC.
- Manu will not be entitled to an input tax deduction on his spending on UTBC levies. This is because the services received are not used for the principal purpose of making taxable supplies. Manu's apartment is solely his place of residence.

If, instead of an apartment, Manu's unit was a retail electrical store and office which he used in his taxable activity, Manu would be entitled to an input tax deduction in relation to the membership supply (for which levies are consideration). This is because the services he receives from the UTBC are used for the principal purpose of making taxable supplies.

Manager's accommodation

77. In some cases a UTBC will employ or engage a person to act as a manager for the unit title development. The terms of this engagement may include the manager living on-site. In such cases, the UTBC may provide the manager with an apartment to live in.
78. This arrangement will involve the UTBC providing a manager with a right to occupy an apartment in the unit title development (eg, by way of lease). The apartment may be owned by the UTBC (eg, as common property), or a member may have leased the apartment to the UTBC for that purpose.
79. Before determining the GST treatment of these transactions, we need to understand the nature of the supplies. Determining the nature of a supply for GST purposes involves considering the legal rights and obligations that the supplier and the recipient enter into, in light of the surrounding circumstances. The wording the parties use will not determine the GST treatment (see *Marac Life Assurance Limited v CIR*;[15] *Chatham Islands Enterprise Trust v CIR*;[16] and *CIR v New Zealand Refining Co Ltd*[17]). This means the GST consequences (if any) of the supply of manager's accommodation in these circumstances depends on the contractual arrangements between the UTBC, the manager, and in some cases, the member who leases the apartment.

Exempt supplies

80. Section 14 of the GST Act specifies certain supplies of goods and services which are exempt from GST. Some of those supplies relate to the supply of residential accommodation. Two of these could apply in the context of manager's accommodation.
81. When a UTBC supplies manager's accommodation, the key exempt supply is the supply of accommodation in a dwelling (s 14(1)(c)).
82. If a member supplies an apartment by way of lease to a UTBC which then uses it to supply manager's accommodation, the first supply by the member would likely be the exempt supply of a property by way of lease that is to be used for the principal purpose of accommodation in a dwelling by any person, other than a registered person in the course or furtherance of a taxable activity (s 14(1)(cb)).
83. Both these exemptions relate to "accommodation in a dwelling", which includes both the direct supply (s 14(1)(c)) and indirect supply – namely, sub-let accommodation (s 14(1)(cb)).
84. To determine whether these supplies are exempt supplies, it is necessary to determine whether the manager is being supplied with "accommodation in a dwelling".
85. The GST Act does not define "accommodation". Of relevance is the definition in the *Concise Oxford English Dictionary* that accommodation is "a room, building, or space in which someone may live or stay".[18] Typically, where a manager needs to live on-site, a UTBC will provide them with an apartment to live in. As a result, it would use the apartment to provide accommodation.

15 (1986) 8 NZTC 5,086 (CA).

16 (1999) 19 NZTC 15,075 (CA).

17 (1997) 18 NZTC 13,187 (CA).

18 12th ed, Oxford University Press, New York (2011).

86. More difficult to establish is whether the apartment satisfies the definition of dwelling in s 2:

> **dwelling**, for a person,—
>
> (a) means premises, as defined in section 2 of the Residential Tenancies Act 1986,—
>
> (i) that the person occupies, or that it can reasonably be foreseen that the person will occupy, as their principal place of residence; and
>
> (ii) in relation to which the person has quiet enjoyment, as that term is used in section 38 of the Residential Tenancies Act 1986; and
>
> (b) includes—
>
> (i) accommodation provided to a person who is occupying the same premises, or part of the same premises, as the supplier of the accommodation and who meets the requirements of paragraph (a)(i):
>
> (ii) any appurtenances belonging to or used with the premises:
>
> (iii) despite paragraph (a)(ii), a residential unit in a retirement village or rest home when the consideration paid or payable for the supply of accommodation in the unit is for the right to occupy the unit; and
>
> (c) excludes a commercial dwelling

87. In summary, the definition of a dwelling is that it:

- is premises, as defined in s 2 of the RTA;
- is a place that the person occupies, or it can reasonably be foreseen that the person will occupy, as their principal place of residence; and
- is a place in relation to which the person has quiet enjoyment, as that term is used in s 38 of the RTA; but
- excludes a commercial dwelling (as defined in s 2).

88. If the apartment is a commercial dwelling, it does not matter whether it meets the other requirements of a dwelling. In that case, both the UTBC's supply and, if applicable, the member's supply to the UTBC would be subject to GST under s 8(1).

89. For most unit title developments, the supply of manager's accommodation would not be a commercial dwelling. However, some unit title developments are run as serviced apartment complexes.

90. A serviced apartment typically involves some combination of the services of cleaning, laundry, rubbish removal, and provision of food or meals. A larger complex may involve services similar to those offered in a large hotel.

91. Even where the unit title development is run as a serviced apartment complex, it seems unlikely that a UTBC would provide a manager with accommodation in a serviced apartment. The accommodation provided is likely to be on a different basis from the accommodation provided to ordinary customers.

Dwelling

92. If the apartment that a UTBC uses to supply accommodation to the manager is not a commercial dwelling, it is necessary to consider whether it satisfies the other features of a dwelling. This is relevant to both the supply from the UTBC to the manager (s 14(1)(c)) and (where applicable), the supply from the member to the UTBC (s 14(1)(cb)). Both these provisions rely on the definition of "dwelling". This involves three main features:

- There are premises, as defined in s 2 of the RTA (see [93]).
- The person occupies, or it can reasonably be foreseen that the person will occupy, the premises as their principal place of residence (see from [94]).
- The person has quiet enjoyment, as that term is used in s 38 of the RTA (see from [96]).

Premises

93. The definition of dwelling refers to "premises" as defined in s 2 of the RTA. Section 2 of the RTA defines premises widely as including any means of shelter placed or erected on any land and intended for occupation on that land. An apartment in an apartment complex will satisfy this definition.

Used as a "principal place of residence"

94. The next requirement is that the manager uses the apartment as their "principal place of residence". Principal place of residence is defined as a place that a person occupies as their main residence for the period to which the agreement for the supply of accommodation relates (s 2). This means that for the supplies to be exempt supplies, the manager needs to occupy the apartment as their main residence.

95. Where a UTBC supplies a manager an apartment that they live in full time for the duration of a contract or period of employment, it is likely this would be their "main residence". However, where a manager does not live full time in the apartment (eg, they only stay at the apartment when they are "on call"), it is unlikely the apartment would be the manager's main residence.

Quiet enjoyment as that term is used in s 38 of the RTA

96. Assuming the apartment is the manager's main residence, the final requirement is that the manager must have quiet enjoyment in relation to the apartment, as that term is used in s 38 of the RTA. In summary, s 38 of the RTA provides that the tenant is entitled to quiet enjoyment of the premises without interruption and that the landlord must not cause or permit any interference with the tenant's reasonable peace, comfort or privacy.

97. Whether the manager is provided with quiet enjoyment is a matter of law (ie, it is determined by the RTA and/or the contractual arrangements between the parties). Where a manager is provided with an apartment from which to manage a unit title development as a term of their engagement it is likely that the provision of the apartment will be subject to the RTA and therefore the manager will have quiet enjoyment under s 38 of the RTA. Alternatively, the parties may otherwise agree either that the RTA applies or that the manager has quiet enjoyment as that term is used in s 38 of the RTA. The GST classification of this supply does not change if there is a breach of the manager's right to quiet enjoyment in a particular case.

Conclusion on manager's accommodation

98. Whether the supply of manager's accommodation in the context of a unit title development is an exempt supply or subject to GST depends on whether the apartment is used to provide accommodation in a dwelling.

99. For a unit title development that is run as a serviced apartment complex, the apartment owner and UTBC will need to first consider whether the apartment the UTBC supplies to the manager is a "commercial dwelling".

100. Where the apartment is not a commercial dwelling, the UTBC and member will need to consider whether the manager's use of the apartment satisfies the other requirements of the definition of dwelling. It will satisfy those requirements when:
    - the manager occupies, or it can be reasonably be foreseen that the manager will occupy, the premises as their principal place of residence; and
    - the manager has quiet enjoyment, as that term is used in s 38 of the RTA.

101. If the apartment is the manager's only residence and they live there full time, this will be their principal place of residence. If the manager has another residence that they live at when they are not on call, it is unlikely the manager's accommodation will be their principal place of residence.

102. Whether the manager has quiet enjoyment under the RTA depends on the facts of each case. If they have quiet enjoyment (and the apartment is their main home), the UTBC's supply of accommodation to the manager will be exempt under s 14(1)(c). If a member leases an apartment to the UTBC which uses it to provide accommodation to the manager, the member's supply of the apartment by way of lease to the UTBC will also be an exempt supply under s 14(1)(cb).

Ground rent

103. The general position under s 5(8A) is that all levies a UTBC receives from members are treated as consideration for supplies the UTBC makes to members. This means a UTBC must pay output tax on funds it levies or collects from its members. However, an exclusion applies to some amounts that relate to exempt supplies. Section 5(8A) provides:

> 5 Meaning of term supply
>
> ...
>
> (8A) For the purposes of this Act, a levy or other amount paid to a unit title body corporate by a member of the body corporate, **other than as reimbursement for a payment by the body corporate of an amount that would, if not charged to the body corporate, be payable by the member for an exempt supply to the member**, is treated as being consideration received for services supplied by the body corporate to the member. [Emphasis added]

104. We call this exclusion the "levy exclusion" as it has the effect of excluding some levies or payments from being "consideration for services supplied". Where the levy exclusion applies to a payment, the UTBC will not have an output tax liability to that extent.

105. The levy exclusion was inserted into s 5(8A) in 2022.[19] It was intended to remedy an issue identified under the previous s 5(8A). This issue arose for a GST-registered UTBC of a unit title development on leasehold land. Under the previous s 5(8A), levy payments from members to a UTBC would be consideration for taxable supplies, even when the UTBC raised the levies to pay for an exempt supply of leasehold land by way of rental. This meant members were charged GST in relation to money the UTBC levied to pay for an exempt supply.

106. The supply of leasehold land by way of rental is an exempt supply to the extent the land is used for the principal purpose of accommodation in a dwelling erected on that land (s 14(1)(ca)).[20]

107. Where a unit title development is on leasehold land, the UTBC is supplied with leasehold land and pays ground rent (consideration) to the landowner. To the extent this land is used for the principal purpose of accommodation in a dwelling, the supply of leasehold land by way of rental is an exempt supply. To the extent the supply is an exempt supply, it will not be charged with GST.

108. To pay ground rent, a UTBC will need to levy its members (membership supply). The levy exclusion may apply to these payments. This means a UTBC may not be liable for output tax for some amounts that members pay.

109. The levy exclusion is limited to the following circumstances:

- The amount a member paid is a reimbursement of an amount charged to the UTBC.
- If not charged, the amount would be payable by a member for an exempt supply to the member.

Reimbursement

110. The GST Act does not define the term "reimbursement". The ordinary meaning in the *Oxford English Dictionary* is:[21]

> **reimbursement**, n. The act of reimbursing a sum of money or person; repayment; an instance of this.
>
> **Reimburse**, v. a. transitive. To repay (a sum of money which has been spent or lost).

111. The ordinary meaning of "reimbursement" involves the payment of a sum of money to another person to repay an amount that has already been spent. In practice, a UTBC is likely to levy its members before paying ground rent to the landowner. Despite this, the Commissioner considers the word "reimbursement" describes the relationship between the amount paid by the member and the amount of ground rent paid (or to be paid) by the UTBC.

112. The levy exclusion only applies to the extent the payment by the member relates to the cost of ground rent to the UTBC. If a UTBC levies funds which are to be used for multiple purposes (including the payment of ground rent), the levy exclusion will only apply to the extent those levied funds are for the subsequent payment of ground rent.

Exempt nature of supply

113. The levy exclusion only applies where, if the amount was not charged to the UTBC, it would be payable by the member for an exempt supply to the member. Where a member's payment to the UTBC is a reimbursement of ground rent, the supply of leasehold land by way of rental for which ground rent is consideration must have been an exempt supply. This is important because the supply of leasehold land by way of rental is only an exempt supply to the extent the land is used for the principal purpose of accommodation in a dwelling (s 14(1)(ca)).

114. From [80], we discussed s 14(1) in relation to the supply of manager's accommodation. The focus was on paragraphs (c) and (cb) relating to the direct and indirect supply of residential accommodation in a dwelling. For the supply of leasehold land by way of rental, the relevant paragraph is (ca), requiring the **land** to be used for the principal purpose of accommodation in a dwelling erected on that land.

115. Section 14(1)(ca) is relevant to both the supply of leasehold land by way of rental (from the landowner to the UTBC) and the levy payment from the member to the UTBC. As members of a UTBC could use their units for different purposes, the overall supply of leasehold land by way of rental could be partially exempt. This means the levy exclusion would apply to

19 Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022, s 8(3).

20 The effect of this provision is the subject of a public ruling: **BR Pub 08/01: GST – When the supply of leasehold land is an exempt supply**, *Tax Information Bulletin* Vol 20, No 7 (August 2008): 13, discussed from [122].

21 *Oxford English Dictionary* (online ed, 3rd ed, Oxford University Press, December 2008, OED Online Version June 2022, accessed 21 July 2022).

levy payments from some members and not others. This could occur when a unit title development includes an apartment complex with shops on the ground floor (see from [122]).

116. As we discussed from [80] in relation to manager's accommodation, an apartment would be used for the principal purpose of accommodation in a dwelling in these circumstances:
    - The apartment is not a commercial dwelling (ie, not a serviced apartment or other commercial dwelling as defined in s 2).
    - The occupant uses the apartment as their principal place of residence or main home.
    - The occupant has the right of quiet enjoyment as that term is used in s 38 of the RTA.

117. Because a unit title development will include both apartments and other areas (eg, car parks, storage lockers and common areas), it is necessary to determine:
    - whether these areas would be within the scope of a "dwelling"; and
    - whether and to what extent the common area could be "used for the principal purpose of accommodation in a dwelling".

118. The definition of dwelling includes "appurtenances belonging to or used with the dwelling". The GST Act does not define the word "appurtenance". The courts considered the meaning of "appurtenances" in *Norfolk Apartments Ltd v CIR*[22] and briefly in *Wairakei Court Ltd v CIR*.[23] Both cases concerned retirement villages. At issue was whether the definition of dwelling extended to common areas or facilities. Both courts held that appurtenances include areas that a person who has the right to occupy a dwelling has the right to use (whether exclusively or shared with others) along with their use of the dwelling. The focus is on whether the appurtenance belongs to or is used with the premises.

119. For a unit title development, appurtenances could include either or both of the following:
    - **Accessory units** which "belong to" a principal unit (it is not possible to deal with accessory units independently from the principal unit to which they relate): An accessory unit would typically be an appurtenance that "belongs to" the principal unit. If that principal unit were a dwelling, the accessory unit would be included within that dwelling. An accessory unit could contain a storage locker or a car park.
    - **Car parks contained on principal units**: While it is possible to deal with them independently, they may still be "used with" the premises that is the dwelling.

120. As a result, units that are outside the physical confines of an apartment may still form part of the dwelling because they are an appurtenance of the principal unit. This is consistent with the position in **IS 15/02: Goods and Services Tax – GST and retirement villages**[24] in the context of retirement villages and **IS 20/05: GST – Supplies of residences and other real property**.[25]

121. This means that for most residential unit title developments, the common areas, accessory units and car parks will not prevent the landlord's supply of leasehold land by way of rental to the UTBC from being an exempt supply under s 14(1)(ca).

Mixed-use developments

122. Some unit title developments may have mixed uses. Some units or apartments may be used for accommodation in a dwelling, while others may not be. As we noted at [115], one example is an apartment complex with shops on the ground floor. Another is an apartment complex where apartments are not used as a dwelling but are instead used for other purposes. This would have an impact on apportionment where apartments are serviced apartments (ie, a commercial dwelling), or where apartments are used principally for short-stay accommodation (ie, not used "for the principal purpose of accommodation in a dwelling").

123. In these cases, the supply of leasehold land by way of rental should be apportioned by the landowner to the extent it is exempt and non-exempt. Public Ruling BR 08/01 explains apportionment of supplies under s 14(1)(ca). It confirms the following points:
    - The focus of the provision is on the **actual use** of the land.

22 (1995) 17 NZTC 12,212 (CA).
23 (1999) 19 NZTC 15,202 (HC).
24 *Tax Information Bulletin* Vol 27, No 11 (December 2015): 6.
25 *Tax Information Bulletin* Vol 32, No 7 (August 2020): 85.

- The words "to the extent" contemplate apportionment in terms of the overall supply. This means it is not necessary for the entire piece of land to be used for the principal purpose of accommodation in a dwelling for s 14(1)(ca) to apply in relation to part of the supply.
- If a portion of the land is used for the principal purpose of accommodation in a dwelling, s 14(1)(ca) will apply to that extent. This means that a piece of land could be used 25% for the principal purpose of accommodation in a dwelling and 75% for non-exempt purposes and s 14(1)(ca) will apply to 25% of the supply.

124. While BR 08/01 provides general guidance on apportionment, it does not discuss apportionment and the application of s 14(1)(ca) in the context of a unit title development.
125. For a unit title development, apportionment under s 14(1)(ca) will generally not need to take the common property into account. This is because the common property exists to facilitate the uses of the units within the development, so would be used proportionally in the same way as the units. Similarly, in residential unit title developments, accessory units and car parks will generally be appurtenances of the principal units and should not significantly affect the apportionment calculation.
126. However, where the accessory units and car parks are used disproportionately to the ways in which the principal units are used, this may affect the apportionment calculation. This situation could occur in a mixed-use development where all the car parks in the development are used with owner-occupied apartments. In this case, it would be necessary to consider both the principal units (owner-occupied apartments and commercial premises) and the car parks to determine the extent to which the land is used for the principal purpose of accommodation in a dwelling.

Mixed-use developments: method of apportionment

127. For a unit title development where the units are largely identical, it may be appropriate to apportion based on the number of units. If the units are not the same size, using floor space would be an appropriate method to apportion the supply of leasehold land by way of rental under s 14(1)(ca). This would involve calculating the floor space of units used for the principal purpose of accommodation in a dwelling, and those that are not used for those purposes. Comparing these two amounts would provide a percentage of the extent to which the land is used for those purposes. The landowner can use this percentage to determine the extent to which the supply of leasehold land by way of rental is an exempt supply.
128. Using floor space to apportion between taxable and exempt supplies is generally a reasonable basis to use for landowners for the supply of leasehold land by way of rental under s 14(1)(ca) (third-party supplies). However, it may not reflect how the UTBC apportions the cost of ground rent among members (membership supplies) through levies based on their ownership or utility interests (see [15]).

Apportionment by ownership or utility interests

129. Another method of apportionment that could be used with a unit title development on leasehold land is based on the ownership or utility interests assigned to the various units. A UTBC levies its members based on the ownership interest or utility interest assigned to their units.
130. As a UTBC already uses these interests to apportion costs to the development (including the cost of ground rent), it can be appropriate to also use these interests in the context of a unit title development on leasehold land.
131. Apportionment outcomes based on relative interests may differ in minor ways from those based on floor space. For example, two apartments may be of equal size, but one may be higher in the complex or have a better view. These factors may cause the interest attaching to the second apartment to be different to that for the first, unlike apportionment based on floor space.
132. Example | Tauira 6 describes the GST treatment of ground rent for a UTBC that is fully residential. Example | Tauira 7 shows the different calculations that a landowner and UTBC will need to undertake in apportioning supplies for mixed-use developments. Example | Tauira 8 illustrates how if the landowner and the UTBC use different apportionment methods, their output tax liabilities may be different.

Example | Tauira 6: Ground lease for residential apartment complex

Body Corporate Number 600,000 is a GST-registered UTBC for an apartment complex on leasehold land. It consists of 10 apartments that are all owner-occupied.

Magnus Land Ltd owns the land. Based on s 14(1)(ca), it issues an invoice to the UTBC for $4,600 for the ground rent.

Combined with the cost of ground rent, the UTBC has total expenses of $13,800 which it needs to levy members to pay for. Therefore, the UTBC issues invoices constituting taxable supply information to each of its 10 members for $1,380. Each of these are split into two amounts:

- $920 (including GST of $120)[26] to cover the UTBC's general expenses.
- $460 to cover the cost of ground rent to the UTBC.

The levy exclusion applies to the $4,600 levied from owners to pay for ground rent. This amount is an amount that would, if not charged to the body corporate, be payable by the member for an exempt supply to the member. As each member lives in their apartment as their principal place of residence, the supply would be exempt under s 14(1)(ca).

As the levy exclusion will apply to the amount it collects for ground rent, the UTBC will only need to account for output tax on $9,200. This is because the portion relating to ground rent is excluded from being consideration for a taxable supply.

The UTBC pays $4,600 in ground rent to the landowner for the supply of leasehold land by way of rental (an exempt supply). This means the UTBC has not been charged GST and is not entitled to an input tax deduction.

Example | Tauira 7: A mixed-use unit title development on leasehold land

Body Corporate Number 700,000 is a GST-registered UTBC for a unit title development on leasehold land. It has four principal units in total. These units consist of two commercial units on the ground floor (a restaurant and a clothing store) and two owner-occupied apartments on the first floor.

Magnus Land Ltd owns the land. Based on s 14(1)(ca), it determines that 50% of the land is used for the principal purpose of accommodation in a dwelling (as half of the development is used for residential accommodation). Accordingly, it issues an invoice constituting taxable supply information to the UTBC for $4,945 for the ground rent, split into two amounts:

- $2,300 + GST ($2,645); and
- $2,300 showing no GST.

In addition to the ground rent, the UTBC incurs expenses of $4,000 (excluding GST) for which it needs to levy members. On the basis that each of the units has the same floor space, the UTBC levies the members to cover ground rent and other expenses:

- It levies the owners of the commercial units $3,795 (inclusive of GST (($2,300 + $1,000) × 1.15).
- It levies the owner-occupiers $3,450 (inclusive of GST). It does not charge GST on the portion of the levies subject to the levy exclusion ($2,300 + ($1,000 × 1.15)).

26 $800 x 1.15 = $920.

Example | Tauira 8: Apportionment – floor space vs ownership interest

Body Corporate Number 800,000 is a registered UTBC for a unit title development on leasehold land. The development consists of two units of equal floor space. One of these units is used for residential purposes, while the other is used for commercial purposes.

The residential unit has an ownership interest based on a value of $400,000.

The commercial unit has an ownership interest based on a value of $600,000.

The UTBC has not assigned any specific utility interests, so these are the same as the ownership interests.

Third-party supply

The landowner charges ground rent of $10,000. The landowner uses the respective floor space of the units to calculate the extent to which the land is used for the principal purpose of accommodation in a dwelling.

As a result, including GST on half of the supply of leasehold land by way of rental, the amount charged is $10,750:

Landowner charge	Rent	GST	Total
Residential rent	$5,000	Exempt	$5,000
Commercial rent	$5,000	$750	$5,750
Total			**$10,750**

Membership supply

The UTBC levies its members to pay this amount based on their respective interests. Based on the interests, the ground rent will be divided between the owner of the residential unit $4,000 and the commercial unit $6,000 (before considering GST).

The levy exclusion does not apply to the $6,000 charged to the commercial member. This amount will be consideration for a supply under s 5(8A), and as a result the membership supply in respect of the commercial unit will be charged with GST.

UTBC charge	Rent	GST	Total
Residential rent	$4,000	Exempt	$4,000
Commercial rent	$6,000	$900	$6,900
Total			**$10,900**

Result for the UTBC

In this case, using a different apportionment approach for the third-party supply results in the UTBC having more GST to pay. If the UTBC advised the landowner of the apportionment calculation based on respective interests, the landowner could apportion the supply of leasehold land by way of rental on that basis. If this occurred, they would avoid the mismatch.

Application in practice

133. Landowners who do not know the extent to which the land is being used for the principal purpose of accommodation in a dwelling and who are unable to obtain that information should standard rate the supply of leasehold land by way of rental. This ensures that any GST that may be payable for the supply is accounted for by the landowner at the appropriate time.

Summary of ground rent issue

134. Generally under s 5(8A) all levies a UTBC receives from members are subject to GST. However, levies it raises to pay ground rent to which s 14(1)(ca) applies are exempt from GST. In summary, the issue is as follows:

- Levies a UTBC receives from members as a reimbursement for a payment it makes of an amount that would, if not charged to the body corporate, be payable by the member for an exempt supply to the member can be treated as exempt from GST.

- Where a UTBC charges a mixed levy to pay for ground rent and other expenses, only amounts that relate to the payment of ground rent would satisfy the levy exclusion in s 5(8A).
- Where some units in a unit title development are used for the principal purpose of accommodation in a dwelling and some are not, the landowner's supply of leasehold land by way of rental to a UTBC should be apportioned between land used for the principal purpose of accommodation in a dwelling and land used for other purposes.
  The supply of leasehold land by way of rental is only an exempt supply to the extent it is used for the principal purpose of accommodation in a dwelling (s 14(1)(ca)).
- When apportioning between land used for the principal purpose of accommodation in a dwelling and land used for other purposes, it is likely that apportionment based on the members' ownership or utility interests will be appropriate. However, it may alternatively be reasonable to apportion on a unit basis where the units are largely the same size or using a floor area basis.
- If the method of apportionment used for the supply of leasehold land by way of rental (by the landowner to the UTBC) is different to the way the UTBC calculates levies to pay ground rent, the UTBC and the landowner may have different output tax obligations.

Receiving one-off payments

135. The final set of specific transactions we consider consists of one-off payments that UTBCs receive. Common payments for which people seek guidance on their GST treatment include:
    - settlement payments and court awards;
    - insurance payments; and
    - Ministry of Business, Innovation and Employment (MBIE) payments under the Leaky Homes Financial Assistance Package (FAP).

Court awards and out-of-court settlements

136. Court awards are made by courts and tribunals and in binding arbitrations, usually in response to a wrongful act by one of the parties to a dispute. An out-of-court settlement refers to a payment to settle a dispute where the parties themselves agree on the nature of the settlement.
137. Whether receiving a court award or an out-of-court settlement payment results in a GST output tax liability depends on whether the payment is sufficiently connected to a supply to be consideration for that supply. **IS 23/07** explains the Commissioner's position on the GST treatment of court awards and out-of-court settlements.
138. In many cases the payment of a court award or out-of-court settlement will be compensation for a loss by the recipient. In these cases there is typically no GST consequence as the payment would not have sufficient connection to a supply made by the recipient. However, the legal obligations between the parties need to be assessed to determine whether the payment could, in fact, be for a supply made by the recipient.
139. Example | Tauira 9 demonstrates how the Commissioner's position could apply to a UTBC that receives a one-off payment.

Example | Tauira 9: Terminating or modifying service contract

Body Corporate Number 900,000 is the UTBC of a large unit title development. The development consists of over 150 apartments and multiple commercial premises on the ground floor. The development includes various amenities, such as a pool, gym and cinema, which are available to the occupants to use.

The UTBC has a service contract with Smoother Running Ltd, which provides a range of services in maintaining the amenities and the common property. The contract is for 5 years.

The contract runs relatively smoothly for 3 years until Smoother Running Ltd encounters staffing issues. It wants to consolidate its workforce and focus on other, smaller-scale projects. Given this, Smoother Running Ltd seeks to cancel the contract and allocate staff elsewhere.

Smoother Running Ltd negotiates an early termination to the contract, paying the UTBC $20,000 for early release from the fixed-term contract. The payment is consideration for the UTBC's supply of a service, being the early release from a fixed-term contract. For this reason, it is subject to GST.

The UTBC would have an output tax liability in relation to this supply.

140. In some circumstances, the GST Act will deem specific GST consequences to occur in relation to a compensatory (or similar) payment. Two examples of these are addressed below, being:
    - insurance payments, and
    - MBIE FAP payments

Insurance payments

141. When a registered person receives insurance payments, the result can be that they have an output tax liability based on the amount received. Like the deemed supply under s 5(8A) we discussed from [22], s 5(13) deems insurance payments to be consideration for a supply of services where a registered person receives them in the course or furtherance of their taxable activity.
142. Typically, payments a UTBC receives under the contract of insurance that s 135 of the UTA 2010 requires the UTBC to enter into will be subject to s 5(13). Here, a registered UTBC will need to return GST output tax on the payment. However, s 5(13) does not apply to all payments made under a contract of insurance.
143. The proviso to s 5(13) excludes some payments under a contract of insurance from being deemed to be a consideration for a taxable supply. These exclusions could apply to payments made under a UTBC's contract of insurance. One example is where the supply of the insurance is not a supply charged with tax under s 8(1). This could occur where a UTBC's insurer is not resident in New Zealand (and the insurer does not choose to treat the supply as made in New Zealand). In this case, the UTBC would not have claimed input tax deductions in relation to insurance premiums paid and would not account for output tax on receipt of an insurance payment.
144. The Commissioner has published guidance on the GST treatment of insurance payments:
    - IS 23/07 (referred above at [137]) provides general guidance on the application of s 5(13) from [83] to [94]. This Interpretation Statement explains some of the exceptions to s 5(13), including payments under a contract of insurance that was not made "in New Zealand".
    - **CS 20/01: GST liability for insurance and settlement payments to third party claimants – Section 5(13) of the Goods and Services Tax Act 1985** covers the circumstances where insurance payments go to registered third parties. While that Commissioner's Statement does not address UTBCs specifically, it explains that s 5(13) applies to the recipient when the payment goes directly to a registered third-party claimant instead of to the insured person.

MBIE FAP payments

145. MBIE FAP payments refer to payments that the Ministry of Business, Innovation and Employment makes to UTBCs under the Leaky Homes Financial Assistance Package. MBIE administers the FAP scheme on behalf of the Crown to make payments to eligible claimants as a contribution towards the repair of their leaky property.
146. **CS 20/05: GST treatment of payments received by a GST registered body corporate from the Ministry of Business, Innovation and Employment under the Leaky Homes Financial Assistance Package**[27] sets out the Commissioner's position on GST treatment of MBIE FAP payments that a registered UTBC receives. Essentially, the payment will be treated as being consideration for a supply of goods and services under s 5(6D) of the GST Act. A registered UTBC that receives a payment will need to include this amount in its GST return and pay any net GST output tax.
147. As we discussed from [37] and specifically in Example 1, where an unregistered UTBC receives an MBIE FAP payment, it would **not** make the UTBC liable to register. An unregistered UTBC would not need to account for GST for such an amount.

27 *Tax Information Bulletin* Vol 32, No 10 (November 2020): 2.

References | Tohutoro

Case references | Tohutoro kēhi

Body Corporate 198900 v Bhana Apartments Ltd [2015] NZHC 1620

Chatham Islands Enterprise Trust v CIR (1999) 19 NZTC 15,075 (CA)

CIR v New Zealand Refining Co Ltd (1997) 18 NZTC 13,187 (CA)

Marac Life Assurance Limited v CIR (1986) 8 NZTC 5,086 (CA)

Norfolk Apartments Ltd v CIR (1995) 17 NZTC 12,212 (CA)

Taupo Ika Nui Body Corporate v CIR (1997) 18 NZTC 13,147 (HC)

Wairakei Court Ltd v CIR (1999) 19 NZTC 15,202 (HC)

Legislative references | Tohutoro whakatureture

Goods and Services Tax Act 1985, ss 2 ("commercial dwelling", "common property", "dwelling", "goods", "money", "principal place of residence", "services"), 3, 5, 8, 9, 10(7A),14, 20, 21B, 21F, 21HC, 51, 52

Residential Tenancies Act 1986, ss 2 ("premises"), 38

Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016

Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Bill 2015 (7—1)

Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022, s 8

Unit Titles Act 2010, ss 5 ("common property"), 7, 38, 39, 41, 75, 78, 81, 84, 115–119, 121, 130, 135

Other references | Tohutoro anō

BR Pub 08/01: GST – When the supply of leasehold land is an exempt supply, *Tax Information Bulletin* Vol 20, No 7 (August 2008): 13
taxtechnical.ird.govt.nz/tib/volume-20---2008/tib-vol20-no7
taxtechnical.ird.govt.nz/en/rulings/public/br-pub-0801-gst-when-the-supply-of-leasehold-land-is-an-exempt-supply

CS 20/01: GST liability for insurance and settlement payments to third party claimants – Section 5(13) of the Goods and Services Tax Act 1985, *Tax Information Bulletin* Vol 32, No 2 (March 2020): 7
taxtechnical.ird.govt.nz/tib/volume-32---2020/tib-vol32-no2

taxtechnical.ird.govt.nz/en/commissioner-s-statements/cs-20-01

CS 20/05: GST treatment of payments received by a GST registered body corporate from the Ministry of Business, Innovation and Employment under the Leaky Homes Financial Assistance Package, *Tax Information Bulletin* Vol 32, No 10 (November 2020): 2
taxtechnical.ird.govt.nz/tib/volume-32---2020/tib-vol32-no10

taxtechnical.ird.govt.nz/commissioner-s-statements/cs-20-05

Concise Oxford Dictionary (12th ed, Oxford University Press, New York (2011))

For-Profit Standards Glossary 2022, External Reporting Board.

IS 10/03: GST: Time of supply – Payments of deposits, including to a stakeholder, *Tax Information Bulletin* Vol 22, No 6 (July 2010): 7
taxtechnical.ird.govt.nz/tib/volume-22---2010/tib-vol22-no6

taxtechnical.ird.govt.nz/en/interpretation-statements/is1003-gst-time-of-supply-payments-of-deposits-including-to-a-stakeholder

IS 15/02: GST and retirement villages, *Tax Information Bulletin* Vol 27, No 11 (December 2015): 6
taxtechnical.ird.govt.nz/tib/volume-27---2015/tib-vol27-no11

taxtechnical.ird.govt.nz/en/interpretation-statements/is-1502-goods-and-services-tax-gst-and-retirement-villages

IS 20/05: GST – Supplies of residences and other real property, *Tax Information Bulletin* Vol 32, No 7 (August 2020): 85
taxtechnical.ird.govt.nz/tib/volume-32---2020/tib-vol32-no7

taxtechnical.ird.govt.nz/en/interpretation-statements/is-20-05-gst-supplies-of-residences

IS 21/01: GST and agency, *Tax Information Bulletin* Vol 33, No 2 (March 2021): 21
taxtechnical.ird.govt.nz/tib/volume-33---2021/tib-vol-33-no2

taxtechnical.ird.govt.nz/en/interpretation-statements/2021/is-21-01

IS 23/07: GST treatment of court awards and out-of-court settlements, *Tax Information Bulletin* Vol 35, No 7 (August 2023): 72
taxtechnical.ird.govt.nz/tib/volume-35---2023/tib-vol35-no7
taxtechnical.ird.govt.nz/interpretation-statements/2023/is-23-07

Oxford English Dictionary (online version, Oxford University Press 2023, accessed 21 July 2022)

IS 23/09: Research and development loss tax credits

Issued | Tukuna: 27 October 2023

This interpretation statement provides guidance on who is eligible for research and development (R&D) loss tax credits. This statement is intended to be read alongside existing information:

- Inland Revenue web guidance Research and development loss tax credit
- Article on the introduction of the R&D loss tax credit regime in *Tax Information Bulletin* Vol 28, No 3 (April 2016):19.

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

Introduction

1. The research and development (R&D) loss tax credit is in subpart MX of the Act. The R&D loss tax credit is a refundable credit available to eligible companies that have a tax loss arising from their eligible research or development expenditure.
2. General information about the R&D loss tax credit is on the Inland Revenue website (research and development loss tax credit) and in an article on the introduction of the regime (*Tax Information Bulletin* Vol 28, No 3 (April 2016):19).
3. This interpretation statement is intended to be read alongside the general information and addresses areas of uncertainty.

Background

4. The R&D loss tax credit was introduced from the 2016 income year to encourage business innovation. Companies engaged in intensive R&D tend to have high up-front costs and losses in their early years.
5. The aim of the R&D loss tax credit is to assist the cashflow of companies involved in intensive R&D by allowing an eligible company to cash-out its tax losses in a relevant year. This means the company can receive a payment instead of carrying forward the tax loss to use against income derived in a later year.
6. Only companies are eligible to claim the R&D loss tax credit. This is because losses incurred by partnerships, limited partnerships, look-through companies and sole traders pass through to the underlying owners, which can often be offset against their other income.
7. The R&D loss tax credit operates on an annual basis. A company chooses whether to apply for the particular year if requirements are met. This means a company can apply in some years and not others. Strict filing timeframes apply.
8. Once a company has claimed an R&D loss tax credit it has additional obligations. The R&D loss tax credit was designed to operate like an interest-free loan, which means the amount of the tax credit will usually be required to be repaid. It is generally treated as repaid by the company paying tax on income it derives in later years once the company is in profit. However, the company may be required to repay the tax credit earlier if an early repayment event occurs. There are also implications for the company's loss balances and imputation credit accounts.

Relationship with the research and development tax incentive

9. The R&D loss tax credit is different from the research and development tax incentive (RDTI) that was introduced from the 2020 tax year.
10. The loss tax credit and the tax incentive are two different regimes with different criteria that must be satisfied. Companies may be eligible for one regime or both.
11. This interpretation statement does not consider the application of the RDTI. However, information about the RDTI can be found on the Inland Revenue website (Research and development tax incentive) and on the Callahan Innovation RDTI hub.

About this statement

12. Part One of this statement considers when a company will be eligible to claim an R&D loss tax credit (the eligibility criteria). This includes considering the type of company that is eligible, the expenses that are relevant for particular calculations, and the qualifying types of R&D activity.
13. Areas of uncertainty that have arisen with applying the eligibility criteria include:
    - what "research" and "development" means for the R&D loss tax credit (from [22])
    - how the eligibility criteria apply to R&D groups (from [42])

- what is included in the wage intensity calculation (from [56]) and
- what qualifies as R&D expenditure (from [85]).

14. Part Two of this statement considers a company's obligations once it is eligible to receive the R&D loss tax credit, including:
    - extinguishing losses and carrying forward excess losses (from [131])
    - when an early repayment of the credit is required (from [138])
    - imputation credits (from [160]); and
    - record keeping requirements (from [165]).

Part One: Eligibility for the R&D loss tax credit

15. This part first summarises the eligibility criteria that must be met in each income year that the R&D loss tax credit is claimed. It then discusses particular areas of uncertainty.

Summary of eligibility criteria

16. A company chooses whether to apply for an R&D loss tax credit in an income year. The company must:
    - be New Zealand resident (s MX 2(a) and (b));
    - not be a:
        - company established under or subject to the Education and Training Act 2020, Pae Ora (Healthy Futures) Act 2022 or Crown Entities Act 2004 (s MX 2(c));
        - company where 50% or more of its shares are owned by a public authority, a local authority, a Crown Research Institute or a State enterprise (s MX 2(d)); or
        - listed company or listed on a recognised exchange (s MX 2(e));
    - have a net loss in the relevant tax year (s MX 1(1)(c));[1]
    - satisfy the wage intensity calculation (ss MX 1(1)(f) and MX 3);
    - incur R&D expenditure in the income year (s MX 1(1)(e)); and
    - own, solely or jointly, the intellectual property and know-how resulting from the R&D (s MX 1(1)(g)).

17. Where the company is part of an R&D group, additional rules need to be met. The combined R&D group must have a net loss for the tax year and satisfy the wage intensity calculation.

18. Some of the above eligibility criteria have given rise to uncertainty. The areas of uncertainty are:
    - whether requirements must be satisfied for a full income year;
    - the meaning of research and development for the R&D loss tax credit;
    - when an R&D group exists and the consequences of grouping;
    - what is included in the wage intensity calculation (including where there is an R&D group);
    - requirements for R&D expenditure; and
    - whether the results of the R&D (that is, the intellectual property and know-how) vest in the company.

19. These issues are addressed in the following paragraphs.

Criteria must be satisfied for the full income year

20. A company must meet the eligibility criteria for an income year (s MX 1). This requirement means:
    - If a company is incorporated during an income year, it must meet the criteria for the part of the year that it exists (s MX 2).
    - If a company that exists for a full income year is eligible for part of that income year only, it has not met the criteria for the income year and cannot claim the R&D loss tax credit for that income year.
    - If a company has a non-standard balance date it must meet the criteria for its income year (for example, from 1 July to 30 June).[2]

1 That is, its annual total deductions are greater than its annual total income.

2 A non-standard balance date is a balance date other than 31 March.

21. Example | Tauira 1 demonstrates a company that is not eligible to claim an R&D loss tax credit because it does not meet the requirements for the full income year.

Example | Tauira 1: Not eligible for full income year

> A company with a standard balance date meets the eligibility requirements under ss MX 1 and MX 2 on 1 April 2022 (the beginning of its 2023 income year). However, it lists on the NZX during that year. This means the company no longer satisfies the requirements of s MX 2(e). As the company does not meet the eligibility requirements for the full income year, it cannot claim an R&D loss tax credit for the 2023 income year.

Meaning of "research" and "development"

22. Central to the R&D loss tax credit are the concepts of "research" and "development". For instance, the R&D loss tax credit is available to eligible companies who:
    - incur expenditure on certain research or development activities (R&D expenditure); and
    - satisfy the wage intensity calculation, which is based on an employee's involvement in research or development (R&D material).
23. The R&D loss tax credit rules adopt the definitions of "research" and "development" in **New Zealand equivalent to international accounting standard 38 intangible assets** (NZ IAS 38). Although the R&D loss tax credit rules adopt these definitions, a company does not need to report under the **New Zealand equivalent to international financial reporting standard** (NZ IFRS) or have adopted NZ IAS 38 to be eligible to claim an R&D loss tax credit. However, whether a company applies NZ IAS 38 for financial reporting purposes may impact its ability to deduct expenditure on research and development and therefore the amount of any net loss and ability to include the expenditure as R&D expenditure (the meaning of R&D expenditure is discussed from [86]).
24. These definitions of research and development are not the same as the meaning of "research and development activity" used for the RDTI. The relevant definitions for the RDTI are in s LY 2 and are relevant to that regime only.

Research

25. "Research" is defined in NZ IAS 38 at [8] as:

    > original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

26. While only the definition is relevant for these purposes, NZ IAS 38 lists examples of research activities at [56] as:[3]
    - activities aimed at obtaining new knowledge;
    - the search for, evaluation of and final selection of, applications of research findings or other knowledge;
    - the search for alternatives for materials, devices, products, processes, systems or services; and
    - the formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.
27. The definition of research (and listed examples) focuses on original investigation and activities that contribute knowledge and understanding.
28. The work must be original. This term is relevantly defined in the *Oxford English Dictionary* (online edition) as:

    > 1.a. That is the origin or source of something; from which something springs, proceeds, or is derived; primary.
    >
    > 2.a. Belonging to the beginning or earliest stage of something; existing at or from the first; earliest, first in time.
    >
    > 5.a. Created, composed, or done by a person directly; produced first-hand; not imitated or copied from another.
    >
    > 6.a. Having the quality of that which proceeds directly from oneself; such as has not been done or produced before; novel or fresh in character or style.

29. The ordinary meaning of "original" refers to something being created and novel, not imitated or copied. This meaning suggests there must be a level of innovation or creativity.

3 For completeness, this is subject to the discussion at [28] and [29] that the research work must be original.

Development

30. Development is defined in NZ IAS 38 at [8] as:

> the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.

31. While only the definition is relevant for these purposes, NZ IAS 38 lists examples of development activities at [59] as the:
    - design, construction and testing of pre-production or pre-use prototypes and models;
    - design of tools, jigs, moulds and dies involving new technology;
    - design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production; and
    - design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.
32. The definition refers to the concept of applying research findings or other knowledge to produce new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.
33. The use of the phrase "or other knowledge" widens the scope of development to include activities other than research that produce something new or improved. That is, development includes activities drawing on existing knowledge gained from research or experience. In addition, development does not consist of ordinary or routine activities based on well-established competence or understanding.

Meaning of "substantially improved"

34. Development activities are those that produce something new or "substantially improved" for the relevant person rather than their business-as-usual activities.
35. The word "substantially" is defined in the *Oxford English Dictionary* (online edition) as:

> **substantially**, adv. Fully, amply; to a great extent or degree; considerably, significantly, much.

36. This definition means the development or improvement must be considerable or significant. Whether the development activities are to create substantially improved materials, devices, products, processes, systems or services always depends on the particular facts.

Before the start of commercial production

37. A question that arises is when a company will have started commercial production (such that an activity is no longer considered to be in development). This question is generally fact dependent and depends on the particular company and its relevant products, processes, systems and so on, that the development work relates to. Examples of when a company has reached the start of commercial production include:
    - demonstrations of commercial viability, market research and promotion;
    - tooling up for commercial production, planning the production process and commissioning new equipment; and
    - developing quality control systems.
38. Guidance on the RTDI refers to R&D performed "in the course of" commercial production, which is a different timing to "before the start of" commercial production.[4] However, that guidance refers to a commercial production environment as including R&D performed on a production line that is producing products for sale, and R&D performed as part of the process of designing, developing or building something where there is a contract in place for the result, or it is for sale. In situations where the company would have started commercial production, the activity will not qualify as being development activity for the purpose of the R&D loss tax credit.
39. However, it is important to note that some activities that occur before the start of commercial production (so would be included as "development" activities) are ineligible under schedule 22.

Schedule 22 proscribed activities

40. To keep the R&D loss tax credit targeted, certain activities listed in schedule 22 are not eligible as research or development expenditure for the R&D loss tax credit. Schedule 22 is relevant to both "R&D expenditure" and "R&D material" for the

4 Research and Development Tax Incentive: Guidance (IR 1240, April 2023) at 66.

wage intensity calculation. The types of activities listed in the schedule are those that take place in a post-development phase, are related to routine work, have an indeterminate relationship with economic growth, or are expected to take place when the company is less likely to be cashflow-constrained.[5] In summary, schedule 22 includes activities that are:

- not performed in New Zealand;
- related to the acquisition or disposal of land, intangible property, intellectual property or core technology;
- related to certain industries (prospecting, exploring or drilling, or research in social sciences, arts and humanities);
- occurring outside core research and development work (for example, activities in the post-development phase or related to routine work) including:
  - market research, testing and promotion;
  - quality control and routine testing;
  - cosmetic alterations;
  - routine collection of information;
  - various legal, commercial, administrative or compliance activities;
  - reproducing a product or process from existing information; and
  - pre-production activities.

41. Example | Tauira 2 demonstrates research and development activity that would not be eligible as either R&D expenditure or R&D material for the wage intensity calculation.

Example | Tauira 2: Overseas activity not eligible for R&D loss tax credit

A Co sends an employee to the United States to supervise the testing of an early prototype in a research facility. The test equipment in the research facility is state of the art, and far exceeds any equipment available to A Co in New Zealand. Although this activity is related to an R&D project being carried on in New Zealand, the activity (the testing of the early prototype) is being performed outside New Zealand.

A Co determines that the expenditure it incurs on the activity outside of New Zealand comprises:

- the amount paid to the owner of the research facility in the United States
- a portion of the salary and wages paid to A Co's employee (based on the time spent by them supervising the testing of the early prototype in the United States)
- the cost of sending the employee to the United States.

These amounts cannot be included in the amount of R&D expenditure, and the salary components do not qualify as total R&D labour expenditure for the wage intensity calculation, because they relate to activities performed outside New Zealand.

R&D groups

42. If a company is a member of an R&D group, this can affect its eligibility to claim an R&D loss tax credit and the amount of the credit. In particular, if there is an R&D group, the:
    - wage intensity calculation must be satisfied for the R&D group; and
    - R&D group must have a net loss.

43. Accordingly, it is important for a company to determine whether it is a member of an R&D group and who the other members of that group are.

An R&D group is a group of companies

44. An R&D group is a concept that only applies for the purposes of the R&D loss tax credit. The concept is broad and applies where a group of companies exists. A company does not elect to be in or out of the R&D group rules – if a company is in a group of companies, then it is a member of an R&D group. The R&D group also includes other entities such as a look

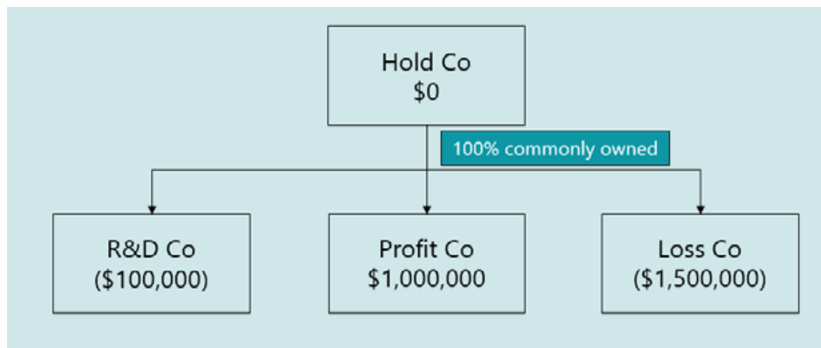
5 *Tax Information Bulletin* Vol 28, No 3 (April 2016): 19 at 20.

through company and limited partnership that must satisfy the same common voting interest thresholds (treated as if it were a company for that purpose).

45. Section IC 3 defines a group of companies as two or more companies (none of which is a multi-rate portfolio investment entity or a listed portfolio investment entity) in relation to which a group of persons holds:
    - common voting interests that add up to at least 66%; and
    - if a market value circumstance exists for a company that is part of a group of companies, common market value interests that add up to at least 66%.

46. A person's common voting interest in the relevant companies at a particular time is the percentage of their voting interests in each of the companies at the time. For further information about how to measure ownership interests see **IS 22/07 Company losses – ownership continuity, sharing and measurement** from 32.

47. For example, all the companies from Example | Tauira 3 below are part of a group of companies so are an R&D group (for the purposes of the R&D loss tax credit) even though only one company undertakes any R&D activities:

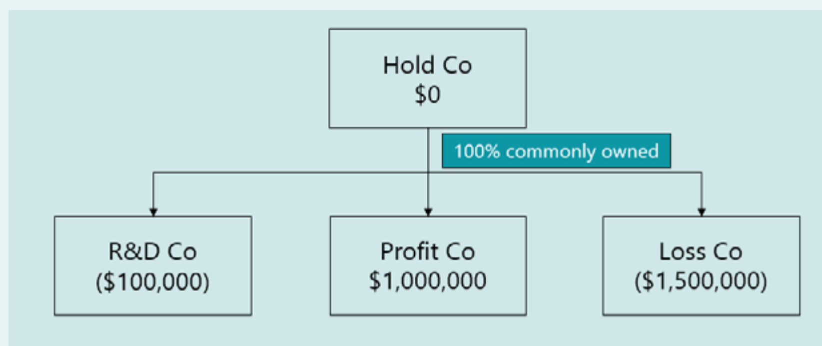


48. Where an entity applying for an R&D loss tax credit is part of an R&D group, its annual application for an R&D loss tax credit must indicate that it is a member of an R&D group.

49. For completeness, where a company is part of a consolidated tax group, the companies in such a group are treated as a single company for tax purposes (s FM 2) and would have a single net loss.

50. A consolidated tax group may be a member of an R&D group. Nothing in the R&D loss tax credit rules suggests a consolidated tax group cannot be eligible for the credit as long as it satisfies the criteria. However, foreign companies cannot be members of a consolidated tax group.

Example | Tauira 3: R&D group has combined net loss



R&D Co carries out R&D and is determining its eligibility for an R&D loss tax credit. R&D Co is a member of an R&D group that includes Profit Co, Loss Co and Hold Co. All entities are New Zealand resident.

Because R&D Co is a member of an R&D group, the net loss requirement needs to be satisfied by both R&D Co and the combined R&D group. R&D Co has a net loss ($100,000). In the relevant income year, the R&D group has a combined net loss of:

($100,000) + ($1,500,000) – $1,000,000 = ($600,000).

This means R&D Co meets the net loss requirement.

Non-resident members of R&D group

51. One issue that arises is whether a non-resident company can be a member of an R&D group, for example, if in Example | Tauira 3 Hold Co was a foreign company.
52. A foreign company can be a member of an R&D group, but only a New Zealand resident company can claim an R&D loss tax credit. This means the foreign company must be included in the calculations for whether the R&D group has a net loss and meets the wage intensity calculation.
53. For the purpose of calculating a foreign company's net income or net loss, that company's New Zealand tax obligations (if any) are what is relevant. Its overseas tax obligations are not included in the calculation of the R&D group's net loss. This is because a net loss is a defined term.
54. A net loss arises where, in a tax year, a person's annual total deduction is more than their annual total income (s BC 4(3)). A person's annual total income reflects their "assessable income" which is the total amount of their income that is not (among other things) non-resident foreign-sourced income. Similarly, a deduction is allowed only where there is a nexus with assessable income. Accordingly, it is only the foreign company's New Zealand sourced income and deductions that are included as its net income or net loss under the Act. This means only its New Zealand net income or net loss is included in the R&D group's calculation (and not its overseas income or loss amounts).
55. Therefore, if Hold Co in the above example was a foreign company, only its New Zealand net loss or net income would be included in the R&D group calculation.

The wage intensity calculation

56. To claim an R&D loss tax credit, an eligible company must satisfy the wage intensity calculation.
57. This requires 20% of a company's total labour expenditure to be on R&D labour (s MX 3)). This requirement ensures companies have a comparatively high level of expenditure on research or development. For companies that are part of an R&D group, the R&D group combined must also calculate their wage intensity.
58. **The wage intensity calculation is only relevant for determining eligibility to claim the R&D loss tax credit.** The required wage intensity is that at least 20% of the company's total labour expenditure must be on R&D labour expenditure, based on the following formula (s MX 3(2)):

    total R&D labour expenditure / total labour expenditure

59. The deductibility (or otherwise) of the labour expenditure is not relevant for the purpose of this calculation. For example, where these amounts are for capital expenditure or are funded by a government grant, that expenditure is still included in this calculation.
60. Uncertainty exists about what is included in or excluded from this calculation and how it affects other calculations (such as R&D expenditure). These uncertainties are addressed in the following paragraphs.

Meaning of total R&D labour expenditure

61. "Total R&D labour expenditure" is defined in s MX 3(3)(a). The focus of the definition is on amounts the company pays to certain persons for providing R&D material.
62. The amounts that must be included in total R&D labour expenditure are:
    - salary and wages paid to employees for providing R&D material;
    - amounts paid to shareholder employees for providing R&D material (the company cannot use a notional amount representing the market value of services that have been provided); and
    - the total amount of contractor R&D consideration multiplied by 0.66.
63. A company can also opt to include as total R&D labour expenditure for each employee who provides R&D material:
    - the employer's superannuation cash contributions for its employee (that are not salary and wages) and the employer's tax on such contributions; and
    - fringe benefits provided by the company and attributed to its employee and the employer's fringe benefit tax liability on those fringe benefits.
64. The amount to be included is the same proportion of the employee's salary and wages that is paid to the employee for providing R&D material.

65. A company might opt to include the amounts described above where a significant portion of the employee's remuneration is made up of fringe benefits or superannuation contributions. Including these optional amounts might enable the company to meet the 20% wage intensity.
66. Importantly, if the optional amounts are included in the amount of total R&D labour expenditure then they must also be included in the amount of total labour expenditure.
67. For a detailed example of this calculation, including the optional amounts, see *Tax Information Bulletin* Vol 28, No 3 (April 2016):19 at 23.

R&D material

68. To be included in total R&D labour expenditure the amount must be paid to the employee, shareholder employee or contractor for providing "R&D material".
69. R&D material refers to goods or services provided to the person to the extent to which:
    - the goods or services are provided as part of a service of research or development;
    - the intellectual property and know-how resulting from the research or development vests in the person, solely or jointly; and
    - the goods and services are not used by the person:
        - for a proscribed activity listed in schedule 22; or
        - to provide a service of research or development or to further another person's research or development activities.
70. If the company uses the goods or services for these qualifying activities as well as other activities, the amount paid to the employee, shareholder employee or contractor must be apportioned.
71. In some cases, an employee, shareholder employee or contractor will provide services other than the provision of R&D material, for example:
    - an employee who carries on research or development on eligible activities, as well as other activities that are proscribed by schedule 22; and
    - a shareholder employee who spends a portion of their time undertaking research or development on eligible activities and the rest of their time carrying out the day-to-day tasks of running the business.
72. Where this occurs, the company must apportion the amounts paid to the employee, shareholder employee or contractor between amounts paid for providing "R&D material" and amounts paid for providing other goods or services. There are no rules for how an apportionment must be applied, although the apportionment method needs to be fair and reasonable and supported by documentation showing how it was reached. For example, the simplest way to work out an apportionment of a person's time would involve the employee accounting for their time on each activity in some way. However, other methods can be used provided the method is fair and reasonable.
73. Proscribed activity was discussed at [40], and whether the intellectual property and know-how vests in the company is discussed at [114]).

Contractor R&D consideration

74. "Contractor R&D consideration" is the GST-exclusive amount a company pays to a contractor as consideration for providing R&D material to the company. The purpose of including only 66% of the total contractor R&D consideration is to exclude the profit margin and non-wage cost components of the contract price on outsourced research or development.
75. Contractor R&D consideration does not include an amount the company pays to a contractor who is, at the time:
    - an employee of the company;
    - a member of an R&D group (that the company is a member of); or
    - an employee of a member of the R&D group that the company is a member of.
76. Issues can arise where, for part of the year, a contractor had been a member (or an employee of a member) of an R&D group that the company is also a member of. In this situation, an amount paid by a company to the contractor is excluded from being contractor R&D consideration if the company and the contractor were in an R&D group at the time the services to which the payment relates were provided. If the company and contractor were not in the same R&D group at that time, the amount can still qualify as contractor R&D consideration.

Meaning of total labour expenditure

77. "Total labour expenditure" is also defined (s MX 3(3)(b)), and means the total expenditure that the company incurred in the income year for:
    - salary and wages paid to all employees;
    - contractor R&D consideration (multiplied by 0.66);
    - the amount paid to all shareholder employees; and
    - the optional amount of expenditure for each employee (that is, for fringe benefits or employer superannuation contributions), if the company has chosen to include these amounts in its total R&D labour expenditure.
78. Example | Tauira 4 and Example | Tauira 5 explain how to apply the calculations.

Example | Tauira 4: Simple wage intensity calculation

B Co pays $200,000 in salary and wages to two full-time staff who are providing R&D material in an income year. B Co's total labour expenditure (salary and wages and shareholder salaries) for all staff (including the two full-time staff providing R&D material) is $1,000,000 in that year.

Wage intensity = total R&D labour expenditure / total labour expenditure

$200,000 / $1,000,000 = 0.2

20% of B Co's total labour expenditure is R&D labour expenditure, so B Co meets the wage intensity requirement.

Example | Tauira 5: Wage intensity calculation including certain expenditure

In the 2023 income year C Co pays:

- $200,000 in salary and wages to two full-time staff for providing R&D material in relation to Project X ($100,000 of this is funded by a government grant);
- $100,000 salary to Tim, a shareholder-employee; and
- total labour expenditure (salary and wages and shareholder salary) for all staff of $1,100,000

Tim carries out development work on Project Y as well as general business duties. Tim separately records his development work on Project Y in a special time sheet code for that project. C Co determines that:

- 50% of Tim's time relates to his provision of R&D material for Project Y, and 50% to other duties; and
- all the expenditure it incurs on Project Y in the 2023 income year is non-deductible for tax purposes.

When calculating the wage intensity, it is not relevant that part of Tim's salary (relating to the work on Project Y) is non-deductible, or that some of the R&D labour salary is funded by a government grant. However, it is relevant that only half Tim's time (and salary) is spent on R&D work.

C Co's wage intensity is:

total R&D labour expenditure / total labour expenditure

($200,000 + ($100,000 * 0.5)) / $1,100,000 = 0.227

As 22.7% of C Co's total labour expenditure is R&D labour expenditure, it meets the requirement.

As is explained in Example | Tauira 10 and Example | Tauira 11, the non-deductibility of part of the salary costs and the government grant funding has consequences for other calculations.

Calculating wage intensity for an R&D group

79. If the company is part of an R&D group, the R&D group must meet the wage intensity calculation in aggregate. This means the total R&D labour expenditure and total labour expenditure are the combined amounts of all the members of the group.
80. The R&D group's total R&D labour expenditure includes payments of salary and wages to each group member's employees or shareholder employees for the provision of R&D material to that relevant group member. Contractor R&D consideration is only for payments made to contractors outside the R&D group.

81. The relevant amounts must be for providing R&D material, which, as previously explained, is only for goods and services provided to the particular company and does not include amounts paid to further another person's R&D activities. There is no allowance in the definition of R&D material for furthering the R&D activities of another group member. This is illustrated in Example | Tauira 6.

Example | Tauira 6: Wage intensity for an R&D group

Op Co and Management Co are owned by the same shareholder, John. Therefore, they are members of an R&D group.

John is the sole employee of Management Co and receives a salary of $200,000. John manages the day-to-day operations of Op Co and Management Co and provides R&D material to Op Co in relation to Project Z.

Op Co carries on eligible R&D activities in relation to Project Z. Op Co incurs salary and wage expenditure of $400,000 in relation to R&D material provided by its employees working on Project Z, and other salary and wage expenditure of $900,000.

Management Co charges Op Co a service fee of $160,000 for John's provision of R&D material in relation to Project Z.

Op Co wage intensity calculation

Op Co's total R&D labour expenditure includes only the salary and wages paid to its employees for providing R&D material ($400,000). Op Co cannot include the amount paid to Management Co for John's services because the payment is not:

- salary or wages of an employee or shareholder employee of Op Co; or
- contractor R&D consideration as this excludes amounts paid to a member of an R&D group that the company (Op Co) is a member of.

Op Co's wage intensity calculation is:

total R&D labour expenditure / total labour expenditure

$400,000 / ($400,000 + $900,000) = 0.307

This means 30.7% of Op Co's total labour expenditure is R&D labour expenditure, and Op Co has sufficient wage intensity.

R&D Group wage intensity calculation

For the group, the total R&D labour expenditure includes the salary and wages paid to employees and shareholder employees of both Op Co and Management Co for providing R&D material. R&D material does not include an employee's services provided to another entity, even within a group. This means the service fee paid for John's R&D contribution is not included in the group aggregate amount, because John did not provide R&D material to Management Co.

The R&D Group's calculation is:

total R&D labour expenditure / total labour expenditure

$400,000 / ($400,000 + $900,000 + $200,000) = 0.266

This means 26.6% of the R&D group's total labour is R&D labour expenditure. The R&D group also has sufficient wage intensity (despite John's service fee not being included).

82. If a member of an R&D group is a foreign company, any salary and wages paid to that company's employees are included in the wage intensity calculation.

83. Where a foreign company's employees are performing R&D activities outside New Zealand, then salary and wages paid to those employees are not included in the total R&D labour expenditure of the group. This is because R&D material does not include activities subject to schedule 22, which includes activities performed outside New Zealand.

84. However, there is no similar exclusion in total labour expenditure. Therefore, all salary and wages paid to all employees (including foreign employees) must be included as total labour expenditure. This is illustrated in Example | Tauira 7.

Example | Tauira 7: Wage intensity calculation with non-resident group member

NZ Co is a wholly owned subsidiary of US Co.

US Co employs three R&D employees who are paid the equivalent of NZ$100,000 each and 10 other employees who are paid the equivalent of NZ$1,500,000 combined.

NZ Co employs two R&D employees who are each paid $100,000 for full time R&D work, and another two employees who are each paid $80,000 for administrative work. NZ Co is working on an R&D project based in New Zealand.

NZ Co's wage intensity calculation

Wage intensity = total R&D labour expenditure / total labour expenditure

$200,000 (2 x $100,000) / $360,000 ((2 x $100,000) + (2 x $80,000)) = 0.55

At 55%, NZ Co has sufficient wage intensity.

R&D group's wage intensity calculation

Only R&D work undertaken in New Zealand qualifies as total R&D labour expenditure. Therefore, the salary paid to US Co's R&D employees does not qualify. However, the amounts paid to all of US Co's employees must be included in the R&D group's total labour expenditure:

= $200,000 + 0 / $360,000 + ((3 x $100,000) + 1,500,000))

= $200,000/ $2,160,000 = 0.09

At 9%, the R&D group does not have sufficient wage intensity. Therefore, NZ Co is not eligible for an R&D loss tax credit.

R&D expenditure

85. The above analysis dealt with issues that arise when determining whether a company is eligible to claim an R&D loss tax credit. The next issue is whether it is incurring eligible R&D expenditure. For eligibility purposes no particular amount of R&D expenditure is required, although the amount is relevant for determining the amount of credit that is available.

86. R&D expenditure is expenditure the company incurs on goods and services to the extent it relates to research or development. Also, the intellectual property and know-how resulting from the research or development must vest in the company (solely or jointly). R&D expenditure excludes expenditure that:
    - relates to an activity described in schedule 22 (proscribed activities);
    - is on goods and services used to provide a service of research or development to another person, or that furthers another person's R&D activities;
    - is not deductible in the income year;
    - is for or under a financial arrangement (such as interest); or
    - is for the acquisition or transfer of intangible property, core technology, intellectual property or know-how.

87. The meaning of R&D, and the schedule 22 proscribed activities, were considered earlier from [22] to [40]. It is also relevant that the R&D work must be undertaken for the company. Expenditure is not eligible where a company undertakes R&D for another person (including another person within an R&D group).

Expenditure that "relates to" research or development

88. A question that arises concerns what goods or services acquired by a business could be said to "relate to" eligible research or development.

89. The words "relate to" mean the expenditure must be "connected to" the research or development activities, and the connection must be more than tenuous.

90. In some cases, a company may incur expenditure for goods and services that relate in part to eligible activities and in part to other activities. For example, salary (and other) costs for R&D staff who also work on ineligible activities, costs of materials or depreciable property used in both R&D work and other work, and some overheads.

91. The cost of the goods and services must have some relationship with the R&D activity to be said to "relate to" that activity (and must not relate to proscribed activities such as routine work under schedule 22). Where expenditure has the relevant relationship, the company must apportion the expenditure between the eligible and ineligible activities. Only the portion that relates to eligible activity counts as R&D expenditure.

92. No specific rules relate to apportionment, but it must be fair and reasonable and able to be quantified in some way. Examples of apportioning overhead costs include:
    - Salary or wages paid to staff who provide services to R&D staff as well as other staff could be apportioned based on time sheet codes, or on a percentage of R&D staff compared with non R&D staff (if that is fair and reasonable).
    - Electricity, insurance and maintenance costs for a building that is used in part for eligible R&D activity and in part for other activity could be apportioned based on the percentage of the area used for R&D compared with other activity.

93. Overheads that do not relate to the R&D work cannot be included in an apportionment. For example, a company's general accounting costs (whether in-house or external accounting costs) would not relate to R&D work undertaken (even if they include expenses incurred in claiming an R&D loss tax credit, those expenses do not relate to the R&D work itself). However, a company can have accounting or finance costs that "relate to" eligible research or development. For example, costs to create budgets for R&D activities/projects.

94. Apportioning an employee's time and overheads are illustrated in Example | Tauira 8 and Example | Tauira 9.

Example | Tauira 8: R&D expenditure – apportionment of an employee's time

ABC Co is a manufacturing company that launched its first product (Product A) in the 2021 income year and is starting to see a steady increase in customers. The company is developing an innovative new product (Product B) as an R&D project.

Jo is employed by the company in the information technology team, and works part-time on the development of Product B. Jo uses a timesheet to record her hours worked and uses a special code for time spent on the R&D project. Over the course of the income year, Jo's time on the R&D project has averaged 35% of her recorded time.

ABC Co includes 35% of Jo's salary as R&D labour expenditure when calculating wage intensity. ABC Co concludes the expenditure on Jo's salary relating to the R&D project satisfies the requirements to be R&D expenditure. Therefore, ABC Co also includes that amount as part of its eligible R&D expenditure.

Example | Tauira 9: R&D expenditure – expenditure related to R&D

X Co employs two full time R&D employees (who undertake eligible R&D work) and 18 other employees.

Bob carries out administrative services on a part time basis. Bob is paid $45,000 for the relevant income year. He undertakes specific administrative services for the R&D employees, as well as general administrative services for other employees. He does not record his time.

Aroha carries out various management and accounting services. Aroha is paid $70,000 for the relevant income year. She is involved in filing tax returns and making the relevant R&D loss tax credit claims.

X Co apportions Bob's time spent on services to R&D staff based on the number of R&D employees in X Co (two) as a proportion of the total number of employees (20). X Co calculates that $4,500 (2/20 x $45,000) can be included as R&D expenditure (and decides the expenditure meets all the other requirements of the R&D expenditure definition). However, as Bob is not providing R&D material, this amount is not included in the total R&D labour expenditure calculation for wage intensity.

Aroha's time (including filing R&D loss tax credit claims) is not sufficiently related to R&D work. Accordingly, no part of her salary can be included as R&D expenditure or total R&D labour expenditure.

X Co incurs other costs including electricity, insurance and ongoing maintenance of its premises that are used partly for its R&D work. X Co has a separate area for the R&D activities undertaken by the two R&D employees and calculates that to be 15% of the total floor spaces of the premises. Therefore, 15% of these overheads can be included as R&D expenditure.

Expenditure must be tax deductible in the year it is incurred

95. Importantly, expenditure only qualifies as R&D expenditure if a deduction is available for the expenditure in the income year. The company must incur the relevant expenditure in the income year in which it claims a credit (s MX 4(1)(h)). Under the definition of R&D expenditure the deduction must also be available in that income year.

96. Sometimes the deduction for expenditure on R&D is allocated to a different income year under s EJ 23. Expenditure for which a deduction is available (but allocated to a different income year) can qualify as R&D expenditure in the income year it is incurred (subject to satisfying the other requirements of R&D expenditure discussed at [86]). However, such expenditure does not qualify as R&D expenditure in the income year it is deducted as only expenditure incurred in the income year qualifies as R&D expenditure.

97. A deduction could be available for research or development expenditure under:
    - a specific provision such as s DB 33 or s DB 34 (research or development) or
    - the general deductibility provision in s DA 1.

98. Uncertainty arose because s DB 34 uses the definitions of "research" and "development" in NZ IAS 38 that are also relevant to the R&D loss tax credit. However, the deduction does not have to be available under that provision.

Deductibility under ss DB 33 and DB 34

99. Section DB 33 provides that a person is allowed a deduction for expenditure incurred in connection with scientific research that they carry on for the purpose of deriving their assessable income. However, it does not apply to expenditure incurred on an asset that is not created from the scientific research and where they are allowed a deduction for depreciation loss. "Scientific research" is not defined for these purposes.

100. Section DB 34 applies to a person who applies NZ IAS 38 for financial reporting purposes. Broadly, under s DB 34, a deduction is allowed for research or development expenditure if the person has recognised the expenditure as an expense under NZ IAS 38. The definitions of research and development for these purposes are the same as those discussed earlier.

101. Section DB 34 effectively applies accounting concepts to determine whether a deduction is available in the income year. If an expense is recognised for accounting purposes (and otherwise satisfies the section) then a deduction is allowed. This differs to general deductibility treatment where accounting treatment is not determinative of deductibility. For further information on the application of s DB 34 see **IG 23/01: Deductibility of software as a service (SaaS) configuration and customisation costs.**

102. Expenditure that is deductible under these provisions must still meet the other requirements previously discussed to be R&D expenditure.

Deductibility under s DA 1 – general permission

103. The other way in which a deduction is available is under general principles. Under s DA 1 a person is allowed a deduction for an amount of expenditure or loss to the extent they incur it in deriving their income, or in the course of carrying on a business for the purpose of deriving income. This is known as the general permission.

104. The expenditure or loss must be incurred in the course of carrying on a business. A sufficient relationship must exist between the expenditure and the business that is being carried on (*CIR v Banks* (1978) 3 NZTC 61,236 (CA) and *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271 (CA)). The type of expenditure and its relevance to the income-earning process are relevant for deciding whether that relationship exists. This includes looking at how the company earns its income and the factual situation at the time the expenditure is incurred.

105. Even where a deduction is allowed under s DA 1, it may be disallowed under the limitations to deductibility. The most likely limitation that can apply to research or development expenditure is for capital expenditure in s DA 2(1). Whether expenditure is of a capital nature is a factual question that needs to be considered in each case.

106. When considering deductibility under general principles, the accounting treatment is of limited relevance. This differs to the position under s DB 34 where companies that apply NZ IAS 38 can generally follow their accounting treatment. Non-deductibility of expenses is illustrated in Example | Tauira 10.

Example | Tauira 10: R&D expenditure – non-deductible expenses

C Co from Example | Tauira 5 is now calculating the amount of R&D expenditure it incurred in the 2023 income year.

C Co paid $200,000 in salary and wages to two staff and 50% (that is, $50,000) of Tim's salary for providing R&D material. C Co does not apply NZ IAS 38. C Co had determined that the amount paid to Tim for his work on Project Y was non-deductible expenditure because it related to a capital project.

Tim's R&D portion of salary ($50,000) was included in C Co's total R&D labour expenditure for the purpose of determining whether it satisfied the wage intensity calculation. However, R&D expenditure excludes expenditure for which no deduction is available in the income year. As the $50,000 shareholder-salary paid to Tim for providing R&D material is not deductible, it cannot be included in C Co's R&D expenditure.

C Co determined that the $200,000 salary and wages paid to the two full-time staff for providing R&D material was deductible. However, see Example | Tauira 11 about the treatment of amounts funded by a government grant.

Government grant funding

107. If a company receives certain types of government grant funding for research or development, and the government grant provisions in ss CX 47 and DF 1 apply, the amount of the grant is not taxable income, but the expense funded by the grant is non-deductible. This means R&D expenditure cannot include any expenditure to the extent it is funded by such a grant.

108. The government grant provisions only apply in certain situations. The grant must be provided by certain types of government agencies, and it must be provided for (otherwise) deductible expenditure. For further information on when the government grant provisions apply see **IS 23/06**: **Income tax – Government payments to businesses (grants and subsidies).**

109. Where the grant funding is less than the relevant expenses, the part of the expense not funded by the grant may still be deductible. This is illustrated in Example | Tauira 11.

Example | Tauira 11: R&D expenditure – government grant funding

C Co (from Example | Tauira 5 and Example | Tauira 10) received a government grant of $100,000 for Project X. The grant was aimed at attracting more R&D staff so required the funds be used for R&D salaries. C Co funded half of its $200,000 R&D salary costs with this grant.

Government grant funding does not affect the wage intensity calculation. C Co's total R&D labour expenditure still includes the $100,000 of staff salaries funded by the grant.

However, when calculating its R&D expenditure, C Co cannot include expenditure that is not deductible. While C Co had determined the salaries were ordinarily deductible, this particular grant satisfied s DF 1. That means the expenses funded by the grant become non-deductible. C Co can only treat the $100,000 salary not funded by the grant as "R&D expenditure".

C Co cannot assume the total R&D labour expenditure is eligible R&D expenditure.

110. Where an R&D project is co-funded, the costs of the project not funded by the government grant may still be deductible. This is illustrated in Example | Tauira 12.

Example | Tauira 12: R&D expenditure – co-funding arrangement

B Co receives a government grant of $100,000 towards a $200,000 R&D project on the basis that B Co's investors will provide the other $100,000 funding.

B Co determines that the government grant provisions in ss CX 47 and DF 1 apply to the $100,000 government grant.

When calculating its R&D expenditure, B Co cannot include expenditure that is not deductible. The R&D project expenses funded by the government grant are non-deductible.

B Co determines that the R&D project expenses co-funded by investors are deductible. Accordingly, these expenses can be included as R&D expenditure provided the other requirements for expenditure to be R&D expenditure are met.

Interaction between wage intensity calculation and "R&D expenditure"

111. An area of uncertainty has been the relationship between the wage intensity calculation and the company's R&D expenditure. In short, there is no relationship between these amounts.

112. Where expenses are excluded from the wage intensity, they may be included in R&D expenditure (and vice versa). Also, neither amount affects the calculation of the company's net loss for tax purposes. These amounts are only relevant as separate indicators of eligibility for the R&D loss tax credit.

113. The maximum amount of credit that can be claimed is discussed in part two of this statement. This includes amounts relating to:
   - the total R&D labour expenditure (part of the wage intensity calculation); and
   - the amount of R&D expenditure incurred.

The company must own the results of the R&D

114. A company can only claim an R&D loss tax credit for R&D activities if the results of those activities (the intellectual property and know-how) vest in the company solely or jointly with another person. The word "vests" in this context means the company owns or has a present legal right to that property.

115. This requirement is included both in relation to the company's eligibility to claim a credit and in the definition of R&D expenditure.

116. The requirement is designed to ensure the person making a claim to cash-out the R&D tax losses is the person who invested in the research or development. However, in recognition that parties may jointly undertake R&D activities, the requirement is satisfied if the intellectual property and know-how vests in the company jointly. For example, two or more companies may agree to carry out R&D activities together and to share ownership of the results.

117. Whether the intellectual property and know-how vests in a person depends on the facts. Usually, the intellectual property and know-how from R&D activities vest in the person carrying out the activity, the creator of the invention or knowledge. However, this might not be the case if, for example, the person is carrying out the activity:
   - in the course of their employment (the intellectual property will usually vest in the employer); or
   - for another person.

118. A company must have sufficient rights in the results of the R&D activities to meet the requirement that the intellectual property and know-how vests in the person. A company will usually satisfy that requirement if it:
   - carries out research or development activities for itself;
   - owns the results of research or development carried out by a contractor on the company's behalf; or
   - has a contractual arrangement with another party to share the results of the research or development.

119. Some R&D groups may structure their operations so that the intellectual property is owned by a separate group company from the company undertaking the research or development. In that case, each company needs to be considered on its own to determine if it meets this requirement. The company undertaking R&D will not qualify for the credit if it is undertaking that work for another person (that is, the person who owns the results of the R&D). Similarly, the company that owns the intellectual property will need to be undertaking enough of its own R&D work to qualify.

120. This requirement differs from the RDTI which applies where the person can use the results from the R&D activity (such as the intellectual property created) for no consideration, or where the results are owned by another company within the same group of companies, or a member of a joint venture that the person is a member of (s LY 3(1)(c)).

121. The ownership of the intellectual property and know-how vesting with a different company to the company undertaking the R&D is illustrated in Example | Tauira 13.

Example | Tauira 13: Intellectual property owned within an R&D group

R&D Co and Op Co are each wholly owned by Hold Co.

R&D Co is a research and development company carrying out eligible R&D activities on behalf of Op Co in the 2022 income year. Op Co owns the intellectual property and know-how generated from the R&D carried out by R&D Co. R&D Co invoices Op Co for R&D work it is undertaking.

R&D Co cannot claim an R&D loss tax credit for the 2022 income year as it is undertaking its R&D work for another company, and also because it does not own the results of its R&D activities. This is the case even though R&D Co and Op Co are members of the same R&D group.

Summary

122. The above analysis considered common issues that have arisen in determining a company's eligibility for the R&D loss tax credit. In brief, an eligible company is one that:
    - chooses in an income year to apply for an R&D loss tax credit;
    - is New Zealand resident and not an ineligible type of company;
    - has a net loss in the tax year;
    - satisfies the wage intensity calculation;
    - incurs eligible R&D expenditure;
    - owns the results of the R&D; and
    - notifies Inland Revenue when it is in an R&D group and in that event the R&D group must:
        - have a combined net loss in the tax year; and
        - satisfy the wage intensity calculation.

123. Having considered it meets all the criteria as explained in this part of this statement, an eligible company is entitled to claim an R&D loss tax credit. Part two of this statement discusses the ongoing obligations of such a company.

Part Two: Obligations and repayments

124. Having determined that a company is eligible for the R&D loss tax credit, this part sets out obligations the company must meet.

Applications

125. The Inland Revenue website provides guidelines on the information needed to support an application for an R&D loss tax credit (Apply for the R&D loss tax credit).

126. The time for filing an R&D statement is provided for in s 70C(2) of the Tax Administration Act 1994 (TAA). For the 2023 and later tax years, the R&D statement must be filed no later than 30 days after the last day for filing the company's income tax return for the relevant income year.[6] The last day for filing a company's income tax return is the date provided for in s 37 of the TAA. If a company does not file the R&D statement by the due date it is not entitled to claim an R&D loss tax credit for that year. The due date for filing the R&D statement is illustrated in Example | Tauira 14.

Example | Tauira 14: Due date for R&D statement

Newco is undertaking R&D in the 2023 income year and has registered for the R&D loss tax credit.

Newco does not have a tax agent and has a standard balance date of 31 March. Newco's income tax return for the 2023 income year is due on 7 July 2023.

If Newco wants to claim an R&D loss tax credit for the 2023 income year it must file its R&D statement no later than 6 August 2023. If it files the R&D statement on 7 August 2023, it will not be eligible to claim a credit.

If Newco has a tax agent, then it will get an extension of time for filing its income tax return. The last day for filing Newco's income tax return for the 2023 income year will be 31 March 2024, and Newco will need to file an R&D statement no later than 30 April 2024.

6 Note different timeframes applied for earlier years.

Calculation of credit

127. The amount of the R&D loss tax credit is calculated under s MX 4. The amount of the available tax credit is the lowest of:
    - for the 2021 and subsequent income years, $560,000;
    - the company's net loss for the tax year x the basic tax rate for a company (28%);
    - the company's total R&D expenditure for the income year x 28%; and
    - 1.5 x the company's total R&D labour expenditure in the income year x 28%.
128. Many of these terms were explained in Part One:
    - A net loss arises where the company's total amount of deductions for the tax year exceeds its total income for the tax year. This amount includes all deductions and all income and is not restricted to R&D (see [54]).
    - A company's total R&D expenditure is the cost of all goods and services that relate to eligible R&D activities in the income year and for which a deduction is available in that year (see [86]).
    - The total R&D labour expenditure is the same amount as determined under the wage intensity calculation (see [61]).
129. A company needs to do all these calculations to determine which amount applies. See the example in the article in *Tax Information Bulletin* Vol 28, No 3 (April 2016):19 at 24. If the company tax rate changes, further calculations may be required under s MX 6. This is also explained at page 24 of the above article.
130. When calculating these amounts, some expenses excluded from some calculations are included in others. The differences between the calculations are summarised in Table | Tūtohi 1 and Example | Tauira 15.

Table | Tūtohi 1: Expenses included in the different calculations

Expense type	Total R&D labour expenditure	Deductible expenditure (R&D expenditure & net loss)
External contractor payments for eligible R&D	Only 66% included	Full amount included (unless capital)
Employees/contractors work on capital R&D projects	Included	Not included (unless s DB 33 or s DB 34 allows)
Payments to member of group or employee of member of group for R&D	Not included	Included (unless capital)
R&D salary/wages funded by government grant (s DF 1)	Included	Not included to the extent funded by grant

Example | Tauira 15: R&D expenditure compared with total R&D labour expenditure

Op Co and Management Co from Example | Tauira 6 are members of an R&D group.

Op Co is carrying on eligible R&D activities (Project Z). It incurs salary and wage expenditure of $400,000 for the team working on Project Z. Op Co had also incurred expenditure of $160,000 for R&D services provided by Management Co (through shareholder employee John).

Op Co excluded the amount paid for the services John provided from its R&D labour expenditure for calculating wage intensity.

However, for calculating its R&D expenditure, Op Co determined that the payment to Management Co is deductible, and it meets all the requirements to be R&D expenditure. Unlike the wage intensity calculation, the R&D expenditure calculation does not limit the contractor payment to 66%. The full amount is included.

Treatment of losses

131. Once the available amount of credit is calculated, the company will have some or all of its net loss extinguished (s MX 5). The loss is extinguished because it has been cashed out by the company claiming the credit.
132. The amount of loss extinguished is:

    the amount of the R&D loss tax credit / the basic tax rate for a company (28%)

133. If the amount of loss extinguished is less than the company's available net tax loss, the remaining losses for that year may be carried forward to the next tax year. For further details about the requirements for carrying forward company losses see IS 22/07.

134. If losses are carried forward the company cannot then cash-out those losses in a later year, but it can offset them against income or they can be carried forward to future years.

135. The extinguishment of losses is illustrated in Example | Tauira 16.

Example | Tauira 16: Calculation of R&D loss tax credit and losses extinguished

Research Co is carrying on an R&D project in the 2022 income year and has:

- a net loss of $700,000;
- total R&D expenditure of $525,000; and
- total R&D labour expenditure of $450,000.

The amount of R&D loss tax credit available is the lowest of:

- $560,000;
- net loss ($700,000) x 28% = $196,000;
- total R&D expenditure ($525,000) x 28% = $147,000; and
- 1.5 x R&D labour expenditure ($675,000) x 28% = $189,000.

The amount available as the R&D loss tax credit is $147,000.

The amount of tax loss extinguished under s MX 5 is:

$147,000 / 28% = $525,000.

Research Co meets the requirements to carry forward its remaining losses and carries forward those tax losses to the next tax year. This is calculated as:

net loss for the year - losses extinguished = losses carried forward

$700,000 - $525,000 = $175,000

Research Co cannot claim the tax losses carried forward ($175,000) as R&D loss tax credits in any subsequent tax year.

Repayment obligations

136. A company that has an R&D loss tax credit has obligations regarding the repayment of the tax credit. This is important for companies to realise, as subsequent events can trigger a requirement to repay the credits that were previously cashed out. Imposing repayment tax is not intended to deter a company from claiming an R&D loss tax credit but reflects that in some circumstances it is appropriate for the R&D loss tax credit to be repaid.

137. The general repayment obligation is that as the company pays tax on income, this is treated as a repayment of the R&D loss tax credit. This is illustrated in Example | Tauira 17.

Example | Tauira 17: Repay R&D loss tax credit by payments of income tax

R&D Co claims an R&D loss tax credit for the 2020 income year of $79,800. This results in the extinguishment of all its 2020 net loss of $285,000. R&D Co has no losses carried forward from prior years.

In the 2021 income year R&D Co has taxable income of $100,000. R&D Co has no losses available to offset against its income as its previous losses were cashed out and extinguished. Accordingly, R&D Co has tax to pay of $28,000 ($100,000 x 28%).

In the following income year R&D Co has taxable income of $200,000. R&D Co has no losses available and has tax to pay of $56,000 ($200,000 x 28%).

At the end of the 2022 income year R&D Co has repaid the R&D loss tax credit claimed ($79,800) through the payment of income tax of an equal amount $79,800 ($28,000 + $51,800). R&D Co has fully repaid the R&D loss tax credits.

Early repayment events – "loss recovery events"

138. In certain situations the company is required to make an early repayment of a previously claimed R&D loss tax credit. These situations are referred to as "loss recovery events". If a loss recovery event occurs the company will have a liability for an amount of R&D repayment tax. The amount of R&D repayment tax depends on the type of event that has occurred.

139. The types of loss recovery events are when:

- the company disposes of or transfers intangible property, core technology, intellectual property or know-how for less than market value, and/or where the amount is not assessable income of the company;
- the company is no longer New Zealand resident;
- a liquidator is appointed; or
- there is a loss of the required shareholder continuity.

140. For detailed discussion of the repayment events see the article in *Tax Information Bulletin* Vol 28, No 3 (April 2016):19 at 25 to 28. Each loss recovery event has a formula for calculating the amount of R&D repayment tax. A component of each calculation is the total amount of R&D loss tax credits that the company has ever claimed (ss MX 7(2)(a), MX 7(4)(a) and s MX 7(6)).

141. Because the R&D repayment tax is calculated from the first year for which the company has claimed an R&D loss tax credit, a company needs to ensure it keeps records to support the calculations that will be required. This means a company needs to keep a record of any repayments it has made (including by paying tax). A company must file an R&D statement in relation to R&D repayment tax that they must pay for a tax year.

142. A company also should keep in mind that, from the first year in which it claims the R&D loss tax credit, the credit may need to be repaid early. As noted below, this means it is best practice to determine the value of any property created by the R&D and the company's shares, on an ongoing basis, in the event that a repayment event occurs.

Disposal of property, core technology, intellectual property or know-how

143. The first loss recovery event is when a company disposes of or transfers intangible property, core technology, intellectual property or know-how. However, a loss recovery event does not arise if the disposal or transfer is:

- to an amalgamated company as part of an amalgamation; or
- at market value or above and the consideration received is assessable income of the company.

144. The market value of property is a factual question that depends on the circumstances of each case. A company that has claimed an R&D loss tax credit may want to give some thought to how to value the property it is creating. This means that if the relevant property is sold, the company will have the information to be able to establish the market value at that time. The relevant market for determining market value is an open market, and not the value to the particular company. This is illustrated in Example | Tauira 18.

Example | Tauira 18: Intellectual Property disposal at market value not a loss recovery event

Startup Co is incorporated in June 2019 to undertake R&D work for an innovative new manufacturing process, with a plan of selling the intellectual property created. However, its R&D project failed, and Startup Co was in the process of winding up its activity.

Startup Co had routinely considered what the intellectual property generated was worth, and sold the intellectual property for open market value to its founder. The amount received is assessable income.

As the intellectual property was sold at market value and was assessable income, no loss recovery event occurs. However, depending on how the company winds up, other events could arise.

Determining market value can be difficult. It is important to realise that the market value is the value on the open market, and not the value to the company that is winding up.

Migration of company

145. The second loss recovery event is when a company fails to meet a corporate eligibility requirement in s MX 2(a) or (b). A company will fail this requirement if it ceases to be a New Zealand resident company or is treated as a resident of a foreign country or territory under a double tax agreement.

Appointment of a liquidator

146. The third loss recovery event occurs if the company has a liquidator appointed.[7] A liquidator can be appointed by special resolution of the company's shareholders, the board of the company, or a court order.

147. The appointment of a liquidator is not the same as the removal of a company from the companies register. A company can be wound up in different ways. This event is only triggered on the appointment of a liquidator.

Loss of shareholder continuity

148. The fourth loss recovery event occurs if the company breaches the shareholder continuity requirements set out in s MX 7(1)(b).

149. Shareholding continuity will not be breached if at least 10% of the voting interests in the company are held by the same group of persons throughout the relevant period. For further information on calculating voting interests see IS 22/07.

150. A company that has claimed an R&D loss tax credit must track shareholding changes in the company from the first credit year (that is, from the first year in respect of which they have claimed an R&D loss tax credit) until the R&D loss tax credits have been repaid in full. This enables the company to determine whether a shareholding continuity breach has occurred.

151. For this event, the value of the company's shares is relevant to the calculation of the amount of R&D repayment tax (refer to Table | Tūtohi 2). As already noted, "market value" is a factual question. A company that has claimed an R&D loss tax credit may want to consider how it will determine the market value of its shares, if there is a breach of the required shareholder continuity.

152. If a holding company is interposed between the original shareholders and the R&D company, that holding company is looked through to the ultimate shareholders (s YC 4). There will not be a breach of the shareholder continuity requirement in that event. This is illustrated in Example | Tauira 19.

Example | Tauira 19: Shareholding continuity – interposed holding company

R&D Co has been carrying on a business of developing widgets since the 2020 income year. R&D Co claimed an R&D loss tax credit for the 2020 income year (the earliest credit year). Since incorporation, the shares in R&D Co have been owned by Jason (50%) and Devendra (50%).

Jason and Devendra set up a holding company with each holding 50% of the shares in Hold Co. In the 2022 income year Jason and Devendra sell their shares in R&D Co to Hold Co.

Although the shares in R&D Co have been sold to Hold Co, the required shareholding continuity has not been breached. Jason and Devendra each hold 50% of the shares in Hold Co and, under s YC 4, are treated as holding 50% in R&D Co throughout the relevant period.

The sale of the shares to Hold Co does not trigger a loss recovery event.

R&D repayment tax

153. The amount of R&D repayment tax is set out in Table | Tūtohi 2 (including which calculation to apply if there are multiple events).

Table | Tūtohi 2: Amount of R&D repayment tax by loss recovery event

Loss recovery event	How much is repaid?	Which calculation?
1 Disposal of property	Lesser of: • balance of unrepaid R&D loss tax credits; or • market value of property disposed of x 0.28.	This applies only if loss recovery event 2 or 3 does not apply.

7 In Taxation (Annual Rates for 2015-16, Research and Development, and Remedial Matters) Bill Officials' report on the Bill (Policy and Regulatory Stewardship, Inland Revenue, 2015) p 18, Officials commented that it was anticipated that a number of companies will be liquidated because they cannot meet their debts and the Commissioner will be an unsecured creditor. The unrecoverable nature of much of this debt was included in the estimated fiscal cost of the policy.

2 Breach of corporate eligibility 3 Liquidator appointed	Balance of unrepaid R&D loss tax credits	This calculation applies over others.
4 Loss of shareholder continuity	Lesser of: • balance of unrepaid R&D loss tax credits; or • market value of shares disposed of x 0.28.	This applies only if loss recovery event 2 or 3 does not apply.

R&D repayment tax – filing obligations

154. A company must file an R&D statement in relation to R&D loss tax credits they claim for a tax year and/or R&D repayment tax they must pay for a tax year. The R&D statement must be filed by the date provided in s 70C(2) of the TAA.

155. There is a place on the R&D statement to notify the Commissioner that a loss recovery event has occurred and the amount of R&D repayment tax that is to be paid for a tax year (s 70C of the TAA). The R&D statement must also show any other repayments of the R&D loss tax credit that have been made in the year, for example, a payment of income tax will reduce the balance of the R&D loss tax credits required to be repaid.

R&D repayment tax – due date for payment

156. The due date for paying the R&D repayment tax is the terminal tax date for the relevant tax year (s 70C(3) of the TAA). The terminal tax date for the company will depend on the company's balance date and whether the company's return of income is linked to a tax agent.

Deduction for repayment tax – s DV 26

157. If a company has an obligation for R&D repayment tax, the company is allowed a deduction for that amount in the same income year under s DV 26.

158. Effectively, the amount of loss that was claimed (and that has to be repaid) is reinstated by the amount of the deduction. This operates to put the company back into the same position it was in before claiming the credits (that is, the loss that was extinguished when credits were claimed). The deduction is allocated to the year in which the company incurs the expenditure on the R&D repayment tax. The company incurs this expenditure in the income year in which the event that gives rise to the R&D repayment tax (the loss recovery event) occurs. This is illustrated in Example | Tauira 20.

159. The amount of the deduction is:

amount of R&D repayment tax / basic tax rate for a company (28%).

Example | Tauira 20: reinstatement of tax losses

R&D Co's ultimate shareholders (Jason and Devendra) from Example | Tauira 19, sold all their shares in January 2021. This means R&D Co has breached shareholder continuity in the 2021 income year. The obligation for the R&D repayment tax arises immediately after the breach in shareholder continuity occurs. R&D Co calculates the amount of R&D repayment tax payable for that year as $735,000.

R&D Co is allowed a deduction for the amount of R&D repayment tax, and this deduction arises in the same income year.

The amount of deduction is calculated under s MX 7(7) as follows:

R&D repayment tax /28%

$735,000/0.28 = $2,625,000

R&D Co has a deduction of $2,625,000.

Imputation credit accounts

160. Imputation credits are credits of tax a company pays on its income and that can be attached to a dividend received by a shareholder. Imputation ensures a shareholder is not effectively taxed twice on the same amount (once when the company earns profit, and again when the shareholder receives a distribution of that profit).

161. Most New Zealand resident companies are required to establish and maintain an imputation credit account (ICA). Under s OB 4, the ICA company will have an imputation credit in their account for an amount of income tax paid.

162. Where an ICA company has claimed an R&D loss tax credit and has not had to pay R&D repayment tax, the company will have an imputation debit for the year calculated under s OB 47B. The amount of the imputation debit is the lesser of:
- the imputation credit that the company has for the year (that is, for amounts of tax paid); and
- the company's total R&D loss tax credits less the imputation debits under s OB 47B for previous income years

163. Because the amount of imputation debit is limited to the amount of tax paid during the year, the ICA company will not end up with a closing debit ICA balance due to the R&D loss tax credit.

164. The effect of this calculation means the company will not be able to attach imputation credits to dividends until it has repaid the R&D loss tax credit amounts in full (whether through paying income tax or R&D repayment tax). For an example, see the article in *Tax Information Bulletin* Vol 28, No 3 (April 2016):19 at 28.

Record keeping for the R&D loss tax credit

165. A company's record keeping requirements are set out in s 22 of the TAA. For guidance on record keeping for the R&D loss tax credit, see the Inland Revenue website (Record keeping for the research and development loss tax credit).

166. A company making a claim for R&D loss tax credits has additional matters to consider from the first credit year until the R&D loss tax credits are fully repaid. If a loss recovery event has occurred, the company will have repayment obligations and will need to be able to calculate the amount of the R&D repayment tax. For this purpose, the company will need to maintain records that will support:
- any shareholding changes (to ensure the required continuity is maintained);
- the market value of the company's shares at the time any shares are disposed of; and
- the market value of the intellectual property and know-how resulting from the research and development (to support the value attributed to it if there is a sale or disposal).

167. If a company has a liquidator appointed, then the liquidator will also have an obligation to file the company's tax return and the R&D statement under s 70C of the TAA.

References | Tohutoro

Legislative references | Tohutoro whakatureture

Income Tax Act 2007, ss BC 4, CX 47, DA 1, DA 2, DB 33, DB 34, DF 1, DV 26, FM 2, IC 3, LY 2, LY 3, subpart MX, OB 4, OB 47B, YA 1 ("contractor R&D consideration", "development", "research", "R&D expenditure", "R&D group", "R&D material", "R&D labour expenditure", "total labour expenditure"), YC 4(2) and Schedule 22

Tax Administration Act 1994, ss 22, 37, 70C

Case references | Tohutoro kēhi

Buckley & Young Ltd v CIR (1978) 3 NZTC 61,271 (CA)

CIR v Banks (1978) 3 NZTC 61,236 (CA)

Other references | Tohutoro anō

IG 23/01: Deductibility of software as a service (SaaS) configuration and customisation costs (interpretation guideline, Inland Revenue, 2023) taxtechnical.ird.govt.nz/interpretation-guidelines/2023/ig-23-01

IS 22/07 Company losses – ownership continuity, sharing and measurement *Tax Information Bulletin* Vol 34, No 11 (December 2022): 53 taxtechnical.ird.govt.nz/tib/volume-34---2022/tib-vol-34-no11; https://www.taxtechnical.ird.govt.nz/interpretation-statements/2022/is-22-07

IS 23/06 Income Tax – Government payments to businesses (grants and subsidies) https://www.taxtechnical.ird.govt.nz/interpretation-statements/2023/is-23-06

Is my R&D eligible? (webpage, Callaghan Innovation, 2023) www.rdti.govt.nz/is-my-r-and-d-eligible/

New legislation: Taxation (Annual Rates For 2015–16, Research and Development, and Remedial Matters) Act 2016 *Tax Information Bulletin* Vol 28, No 3 (April 2016): 19
https://www.taxtechnical.ird.govt.nz/tib/volume-28---2016/tib-vol28-no3

New Zealand Equivalent to International Accounting Standard 38 Intangible Assets (New Zealand Accounting Standards Board of the External Reporting Board, issued November 2004 and incorporates amendments to 31 January 2022)

Record keeping for the research and development loss tax credit (webpage, Inland Revenue, last updated April 2021) https://www.ird.govt.nz/research-and-development/loss-tax-credit/claiming/record-keeping

Research and development loss tax credit (webpage, Inland Revenue, last updated April 2021) www.ird.govt.nz/research-and-development/loss-tax-credit

Research and Development Tax Incentive (webpage, Inland Revenue, last updated 25 June 2021) Research and development tax incentive (ird.govt.nz).

Research and Development Tax Incentive Guidance (IR 1240, April 2023)

Oxford English Dictionary (online edition)

IS 23/10: Deductibility of holding costs for land

Issued | Tukuna: 3 November 2023

This interpretation statement considers the deductibility of holding costs for land and whether the land being taxed on sale is relevant to deductibility. Holding costs are expenses incurred in relation to the ownership of land, such as interest, rates, property insurance, and repairs and maintenance and body corporate levies (provided they are revenue expenses). Holding costs do not include capital improvement costs or expenses that relate only to the use of land.

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

SUPERSEDES | WHAKAKAPIA

- **IS0082:** This interpretation statement supersedes comments in ***IS0082***: Interest deductibility – Public trustee v CIR (Inland Revenue, May 2006) that Pacific Rendezvous Ltd v CIR [1986] 2 NZLR 567 (CA) is authority for interest being fully deductible where all of the borrowed funds are used in an income-earning activity, despite also having some other use – irrespective of the nature of that other use.

  The Commissioner no longer considers that correct and is now of the view that *Pacific Rendezvous* is not authority for interest being fully deductible where land is used both privately and for income-earning.
- **QB 19/08:** This interpretation statement supersedes any statements or conclusions in ***QB 19/08***: How do the standard income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately? (Inland Revenue, May 2019) to the extent they are inconsistent with this Interpretation Statement in terms of deductibility of holding costs for periods land is vacant and where the mixed-use asset rules do not apply.

This Interpretation statement assumes the taxpayer is **not a company**, so s DB 7 is not relevant to interest deductibility and ss DG 10 to DG 14 do not apply.

Summary | Whakarāpopoto

1. This interpretation statement considers the deductibility of holding costs for land and whether the land being taxed on sale is relevant to deductibility. The term holding costs refers to expenses incurred in relation to the ownership of land, such as interest, rates, property insurance, and repairs and maintenance and body corporate levies (provided they are revenue expenses).[1] Holding costs do not include capital improvement costs or expenses that relate only to the use of land.
2. There is a flowchart at [47] to help determine whether, and if so to what extent, holding costs for a particular property are deductible. There is also a fact sheet, IS 23/10 FS, that explains the deductibility outcomes without the detailed explanation and analysis in this Interpretation Statement.

Nexus with income

3. The first requirement for expenditure to be deductible is that it must be incurred by a person either:
   - in deriving assessable income or excluded income or a combination of the two, or
   - in the course of the person carrying on a business for the purpose of deriving assessable income or excluded income or a combination of the two.
4. This means that to be (potentially) deductible, there must be a sufficient nexus between the expenditure and an income-earning process of the taxpayer's. Income does not need to be derived in the year the expenditure is incurred.
5. To determine whether there is a sufficient nexus between holding cost expenditure and the taxpayer's income-earning process, it is necessary to identify the advantage the taxpayer was seeking to gain from the expenditure. It is necessary to consider the factual situation at the time the expenditure was incurred.
6. The use to which land is put is relevant in determining whether holding costs satisfy the nexus requirement in s DA 1. This is true for interest as well as other holding costs, because:

1 See [51].

- The advantage obtained from the payment of interest is the use of borrowed money, so where borrowed money is used to acquire land, whether the interest is (on the face of it) deductible depends on the use to which the land is put in the period in which interest is incurred.
- The advantage obtained from incurring other land holding costs is the continued use and enjoyment of the land, so the use of the land determines whether there is a sufficient relationship between those expenses and the taxpayer's income-earning process.

7. Because holding costs are revenue expenses and (generally)[2] deductible as they are incurred (if they are deductible),[3] the use or uses of the land need to be considered in each income year as the use of the land may change from one year to the next.
8. Land can be used concurrently by more than one person, and can be used concurrently by one person for more than one purpose.
9. The use of land generally means the physical use or occupation of the land (for example, if the property is rented out or stayed at by the owner).
10. However, land may also be used without being physically used, and holding land for resale is a use of land. As such, where land is held on revenue account (for example, under s CB 6 or s CB 7), one use of the land is that it is being held for taxable sale. Therefore, there will be a sufficient nexus between the expenditure and the taxpayer's income-earning process. Whether land is held on revenue or capital account, if it is used to earn rental income, the nexus requirement will be satisfied.
11. If there is some income-earning use of the land (because it is held on revenue account or used to earn rental or other income or both), apportionment may be required (with the expenditure being deductible only in part) if the land is also used privately during some or all of the period it is held (for example, if the taxpayer uses the property for holidays).
12. Where land is held on capital account, it cannot be said that a use of the land is that it is being held for income-earning sale. The property is not committed to an income-earning activity of taxable sale during the period of ownership. The fact the sale of the land may end up being taxed (for example, under the bright-line test) does not alter what it was that the taxpayer was seeking to gain from incurring the expenditure. Therefore, the nexus requirement of the general permission will generally be satisfied in respect of holding costs only if there is current year income-earning (or anticipated income-earning) use of the land (for example, rental use). However, the Commissioner would accept that holding costs for land held on capital account are deductible[4] from the time a binding contract for the sale of land is entered into, if the sale will be taxed. There may be situations where the Commissioner would accept holding costs being deducted[5] from an earlier point in time reasonably close to when a binding contract for (taxable) sale is entered into, but this will be highly fact-dependent.
13. If the nexus requirement of the general permission is satisfied for interest, the rules in subpart DH will need to be considered. Subpart DH disallows interest deductions for many residential properties purchased on or after 27 March 2021 and progressively phases out interest deductions for many residential properties purchased before then.
14. Interest deductions that are disallowed by the interest limitation rules in subpart DH may become deductible if the property is sold and the sale is taxed. If this is the case, the amount that becomes deductible is only the amount that would have been allowed but for subpart DH; for example, the appropriately apportioned amount if apportionment is necessary (see from [15]).

Apportionment

15. The general permission in s DA 1 allows for deductibility only *to the extent* expenditure satisfies the nexus requirement. The private limitation (s DA 2(2)) denies deductibility *to the extent* expenditure is of a private or domestic nature. These provisions clearly contemplate apportionment (meaning expenditure may be deductible only in part).
16. The extent to which holding costs are deductible depends on whether there are other uses of the land (for example, private use), and if so, whether the mixed-use asset rules (the MUA rules) in subpart DG apply. This is because the MUA rules contain a formula that deals with the apportionment of most deductions for certain mixed-use assets, including land.

2 But see footnote 25 on page 33. Note also that s EA 3 (Prepayments) may potentially be relevant to insurance premiums – see [49].

3 Note that the interest limitation rules in subpart DH may apply to disallow (or partly disallow) interest deductions.

4 Subject to any required apportionment and to the interest limitation rules.

5 Subject to any required apportionment and to the interest limitation rules.

Whether the mixed-use asset rules apply

17. The MUA rules apply if, in an income year, the land is:
    - used privately (which includes use by natural person associates, or anyone renting it out for less than 80% of the market value rent);
    - used to derive income; and
    - unused for a least 62 days.
18. "Use" in the MUA rules is defined as "the active use of the asset for its intended purpose". Therefore, land being held on revenue account is not relevant in determining whether the MUA rules apply.
19. If the criteria at [17] are met, a taxpayer can opt out of the MUA rules for the asset in two situations. These situations are where:
    - the gross income from the property for the year is under $4000; or
    - the taxpayer would otherwise have quarantined expenditure under the MUA rules for the year.[6]

If the mixed-use asset rules apply

20. Where the MUA rules apply, most deductible property-related expenses will be apportioned under a specific formula in the rules. If the land is held for income-earning sale (that is, it is held on revenue account), that is not a relevant use of the land for the apportionment formula.

If the mixed-use asset rules do not apply (other than because of opting out)

21. If the MUA rules do not apply (other than because the taxpayer has opted out of them), general apportionment principles are used to determine the extent to which holding cost expenditure is deductible.
22. The purpose of apportionment is to ascertain how much of the expenditure is attributable to the deductible item (in this case, income-earning use) and how much is attributable to the non-deductible item (in this case, private use). Apportionment must be fair and not arbitrary.

Land held on revenue account (that is, held for taxable sale)

23. If land is held on revenue account and the MUA rules do not apply (other than because of opting out) the fact the land is being held for taxable sale is a relevant use of the land in determining deductibility of holding costs. As such, holding costs will be deductible in full (if there is no private use) or in part (if there is private use).
24. If land is held on revenue account, used privately, but not actively used to earn income (for example, rental income), the MUA rules will not apply.
25. It is also possible that land could be held on revenue account, used to earn current year income, used privately during the year, and the MUA rules not apply (other than because of opting-out).
26. In either of these situations, there will be periods of simultaneous income-earning use (being held for taxable sale) and private use of the land.
27. The Commissioner considers that in most situations where land is simultaneously used for income-earning (because it is held on revenue account) and used privately, the most appropriate approach is to apportion on a percentage basis by reference to the relative importance of the income-earning and private uses.
28. In the Commissioner's view, 50:50 is generally an appropriate starting point for apportionment for periods of simultaneous income-earning use (because the property is held on revenue account) and private use. The provisions that mean land is on revenue account do not require a dominant purpose of disposal, and it is difficult to see (absent a particular factual situation) how either the income-earning use or the private use could be considered a more dominant or important use. However, the Commissioner would accept any other basis for apportionment that is fair and reasonable in a taxpayer's particular circumstances.
29. For periods a property held on revenue account and sometimes used privately is vacant or physically unused, the extent of deductibility for holding costs depends on whether there is considered to be non-physical or non-active use of the property. This will be highly fact-specific and requires considering the overall circumstances.

6 This will be the case if the income from the property for the year is less than 2% of the property's value and the deductible expenses for the property under the MUA rules exceed the income.

Land held on capital account (that is, not held for taxable sale)

30. Where land is held on capital account (that is, not held for taxable sale) and there is both income-earning use and private use of the property but the MUA rules do not apply (other than because of opting out), a time-based or time- and space-based apportionment between the current year income-earning and private uses of the property is generally appropriate. Deductible holding costs are fully deductible for periods the property is rented out or available to be rented out.[7] Holding costs are not deductible for periods of private use or periods the property is not available to be rented out.
31. If there is no current year (or anticipated) income-earning use of land (for example, rental use), the general permission will not be satisfied in respect of holding costs if the land is held on capital account. As such, holding costs are not deductible. This is generally the case even if the land ends up being taxed on sale, for example, under the bright-line test. This is because property that is held on capital account is not committed to an income-earning activity of taxable sale during the period of ownership, when holding costs are incurred.
32. However, the approach to apportionment of holding costs would differ from the time a binding contract for the sale of land is entered into, if the sale will be taxed (or potentially earlier, as discussed at [93]). If there is private use of the property between the sale contract being entered into and the date the sale is settled, the Commissioner would accept a 50:50 apportionment as a starting point for those periods, and full deductibility for any time in this period there is no private use.

If the mixed-use asset rules have been opted out of

33. If a taxpayer opts out of the MUA rules for an asset, the income from the "use" of the asset is exempt income.
34. Because "use" is defined in the MUA rules as "the active use of the asset for its intended purpose", only income from the active use (for example, rental) of the asset is exempt income. Any income from the sale of land (that is, if one of the land sale rules applies) is not exempt income.
35. The Act denies deductions for expenditure to the extent to which it is incurred in deriving exempt income.
36. If a property is held on capital account, not sold in the year, and the MUA rules are opted out of, holding costs for that year will not be deductible because they will have been incurred in deriving only exempt income. If the sale ends up being taxed, some holding costs may be deductible (see [159]).
37. If a property is held on revenue account and the MUA rules are opted out of, holding costs will be deductible subject to appropriate apportionment. The discussion on apportionment summarised at [21] to [29] is relevant in this scenario, although in this scenario the additional use of deriving exempt income needs to be factored in.

Ring-fencing

38. Once the deductible portion of holding costs has been calculated, the ring-fencing rules in subpart EL may apply to limit the deductible expenses that can be claimed in a particular income year.
39. The rules generally apply to residential land if the expenses for the year are more than the income (that is, the property, or a portfolio of properties it is part of, is loss-making for the year). If the ring-fencing rules apply, deductions up to the amount of income can be claimed that year. The excess deductible amount that cannot be claimed that year is carried forward and may be used in a future year.
40. Land in the MUA rules is not subject to the ring-fencing rules. Some other residential land may not be subject to the rules, such as land held on revenue account, or land to the extent it is the owner's main home. Relevant criteria need to be met for these exclusions from the rules to apply (ss EL 10 and EL 9).

7 Subject to any space-based apportionment (for example, if people renting the property out cannot use some areas).

Deductible "cost" of land on taxable sale

41. If the sale of property (including land) is taxed, a deduction for the "cost" of the property is allowed under s DB 23.
42. The Act does not define "cost" for the purposes of s DB 23. Case law has established that the term cost can have various meanings, depending on context.
43. The Commissioner considers that the meaning of "cost" of property in s DB 23 is the generally understood meaning of the term, being that which is given to acquire something. For land, this includes the initial outlay to acquire the land as well as the cost of capital improvements, as these form part of the land.
44. Holding costs for land that is taxed on sale do not (generally) form part of the cost of the land. They are expenses incurred in relation to the ownership of land not its acquisition. Therefore, they are not deductible under s DB 23.

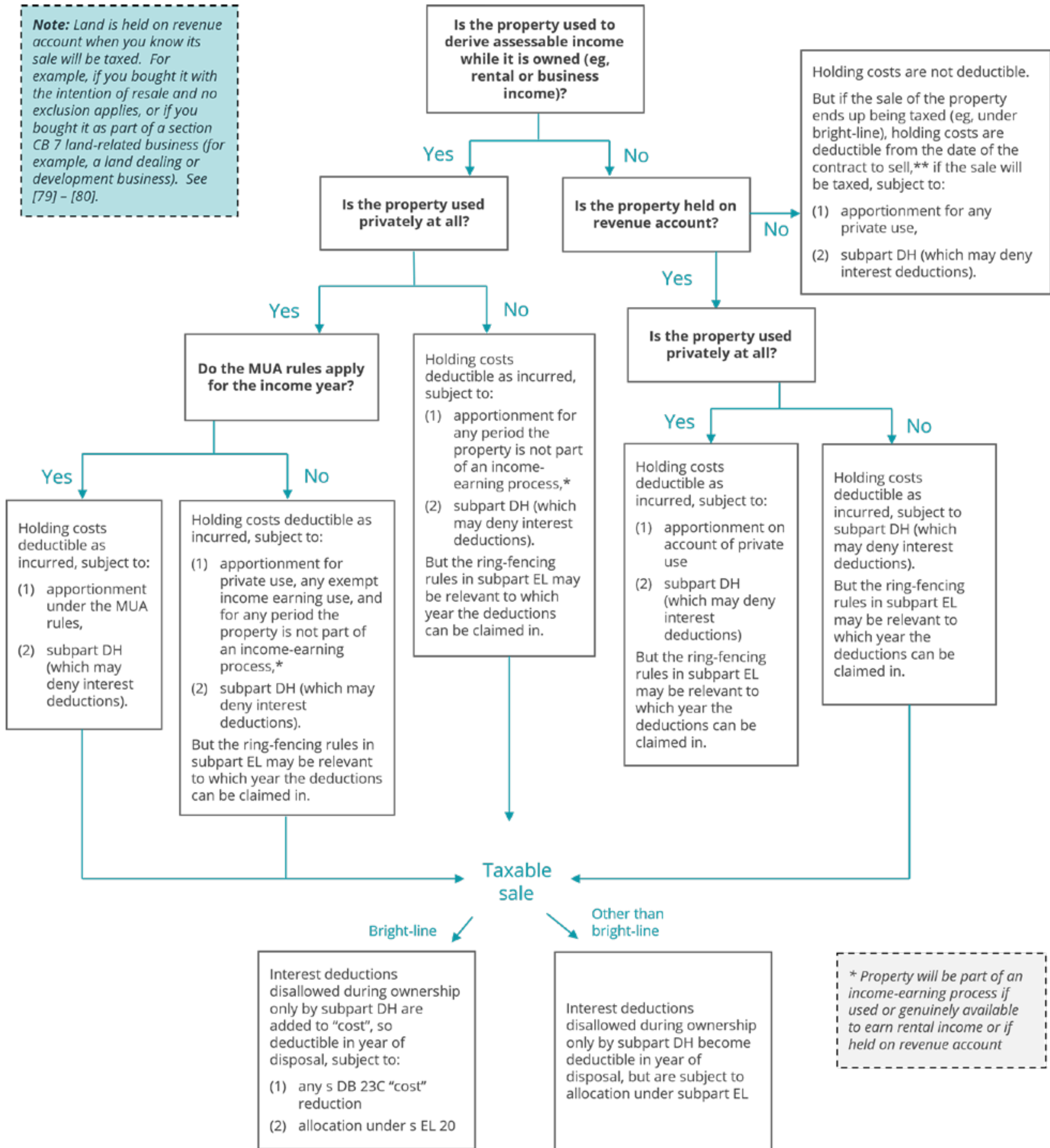
Taxable sale – interest limitation and ring-fencing rules

45. However, if land is taxed under the bright-line test, interest deductions previously disallowed only because of the interest limitation rules in subpart DH are treated as part of the cost of the land. This means those amounts become deductible on the taxable bright-line sale, subject to: (1) a reduction if there has been some main home use of the property, and (2) the bright-line loss quarantine rule in s EL 20.
46. If land is taxed under a provision other than the bright-line test, interest deductions previously disallowed only because of the interest limitation rules are allowed as a deduction in the year of sale. However, these deductions (together with other deductions for the property or a portfolio of properties it is part of) are subject to the ring-fencing rules in subpart EL,[8] which may limit the extent to which the deductions are allocated to the income year in question.

8 Unless an exclusion from the ring-fencing rules applies.

Diagram | Hoahoa: Flowchart – Deductibility of holding costs for land

47. Use the following flowchart to help determine whether, and if so to what extent, holding costs for land are deductible. In all circumstances where holding costs are deductible, note it may be necessary to consider s EA 3 (see [49]).



Introduction | Whakataki

What are holding costs?

In this Interpretation Statement, the term holding costs refers to revenue expenses incurred in relation to the ownership of land, such as interest, rates, property insurance, and repairs and maintenance and body corporate levies (provided they are revenue expenses).[9] Holding costs do not include capital improvements or expenses that relate only to the use of land.

48. We have been asked to clarify the Commissioner's position on the deductibility of holding costs for land taxed on sale under the land sale rules. In particular, we have been asked whether (and if so, the extent to which) holding costs are deductible if land is subject to the bright-line test (ss CB 6A and CZ 39). But the issue also arises for land subject to any of the other land sale rules (ss CB 6 to CB 15).

49. When the whole property is used to earn rental or other income for the whole time it is owned, holding costs are deductible, subject to the:
    - interest limitation rules – which deny interest deductions for many residential properties purchased on or after 27 March 2021, and progressively phase out interest deductions for many residential properties purchased before then; and
    - ring-fencing rules – which limit the deductions that can be taken in any year that deductions exceed income from the property (or a portfolio of properties that the taxpayer owns).

Note also that s EA 3 may potentially be relevant to insurance premiums, if there is an unexpired portion of the expenditure at the end of the person's income year that is not covered by the 12-month exemption in Determination E12: *Persons excused from complying with section EA 3 of the Income Tax Act 2007* (Inland Revenue, March 2009). If s EA 3 applies, the unexpired portion of the expenditure at the end of the income year is income for the person that year, and they are allowed a deduction for that amount in the following income year.

50. But where the property (or part of the property) is not used to earn rental or other income (for example, it is vacant or used privately – whether for the whole time the property is owned or just for periods), there is uncertainty about whether holding costs are deductible (in full or part) on the basis that the ultimate sale of the property is taxed.

51. As noted in the above description of what holding costs are, repairs and maintenance and body corporate levies are included provided they are revenue expenses. IS 12/03: *Income Tax – Deductibility of repairs and maintenance expenditure – General principles* (Inland Revenue, June 2012) will help you identify whether particular repairs and maintenance expenditure is revenue. In terms of body corporate levies, a portion may be a revenue expense and a portion capital – it depends what the particular portion of the levy will be used for. For example, the portion of the levy that will go to the long-term maintenance fund would likely be revenue. However, it would be necessary to consider the long-term maintenance plan to determine if some of the planned maintenance (to be funded by the long-term maintenance fund) would in fact be capital expenditure. If so, the revenue (and so potentially deductible) portion would need to be identified. If there is a capital improvement fund, the portion of the levy that will go to that would be capital, so not deductible. If a taxpayer cannot reasonably identify if a particular portion of a body corporate levy relates to revenue or capital expenditure, it should not be deducted.

9 See [51].

Analysis | Tātari

The issues

52. Three main issues are relevant to the deductibility of holding costs for land that is taxed on sale.

53. The first issue is whether there is a sufficient nexus between the expenditure and an income-earning process to satisfy the general permission for deductibility (s DA 1).

54. The second issue is whether, in a situation where there is the required nexus to satisfy the general permission, holding costs should be apportioned (and be deductible only in part). This needs to be considered because:
    - the general permission allows for deductibility only to the extent expenditure is incurred in deriving assessable income or in the course of carrying on a business for the purpose of deriving assessable income; and
    - the private limitation (s DA 2(2)) denies deductibility to the extent expenditure is of a private or domestic nature.

55. The third issue is whether holding costs for land that is taxed on sale form part of the cost of the property. This issue is relevant to:
    - the timing of any allowable deduction for holding costs, because if holding costs are part of the cost of the land, they would be deductible at the time the property is sold rather than in the year they are incurred (ss DB 23 and EA 2);
    - the ability to deduct holding costs for property held on capital account that is not used to derive current year (or anticipated) income, but that ends up being taxed on sale (for example, under the bright-line test), because a deduction is allowed under s DB 23(1) even if the general permission is not satisfied; and
    - whether holding cost expenditure needs to be apportioned on account of private use of the property if the property is taxed on sale, because, in addition to supplementing the general permission, s DB 23(1) also overrides the private limitation.

56. These issues are considered in turn below.

Whether there is a sufficient nexus between holding cost expenditure and income

57. The first requirement for expenditure to be deductible is that it must be incurred by a person either:
    - in deriving assessable income or excluded income or a combination of the two (s DA 1(1)(a)), or
    - in the course of the person carrying on a business for the purpose of deriving assessable income or excluded income or a combination of the two (s DA 1(1)(b)).

58. This rule is known as the general permission. The general permission is set out in s DA 1:

> **DA 1 General permission**
>
> *Nexus with income*
>
> (1) A person is allowed a deduction for an amount of expenditure or loss, including an amount of depreciation loss, to the extent to which the expenditure or loss is—
>
> (a) incurred by them in deriving—
>
> (i) their assessable income; or
>
> (II) their excluded income; or
>
> (iii) a combination of their assessable income and excluded income; or
>
> (b) incurred by them in the course of carrying on a business for the purpose of deriving—
>
> (i) their assessable income; or
>
> (ii) their excluded income; or
>
> (iii) a combination of their assessable income and excluded income.
>
> *General permission*
>
> (2) Subsection (1) is called the **general permission**.
>
> …

59. This means that to be (potentially) deductible, the expenditure has to have the necessary relationship with the taxpayer and with the gaining or producing of assessable income or with the carrying on of a business for that purpose. In other words, there must be a sufficient nexus between the expenditure and an income-earning process of the taxpayer's.

60. If the general permission is satisfied, there are some general limitations (in s DA 2) to deductibility, including that deductions are denied to the extent expenditure is of a private or domestic nature (the private limitation) and to the extent it is of a capital nature (the capital limitation).
61. Section DB 6 provides for the deductibility of interest. It overrides the capital limitation, so a deduction for interest cannot be denied on the basis that the expenditure is capital expenditure. However, the general permission and other general limitations still apply. In addition, subpart DH contains specific rules for interest deductions. Those rules deny interest deductions for many residential properties purchased on or after 27 March 2021 and progressively phase out interest deductions for many residential properties purchased before then.
62. This Interpretation Statement assumes the taxpayer is not a company. This means s DB 7, which provides that most companies are allowed a deduction for interest without needing to satisfy the general permission, is not relevant to interest deductibility.

The nexus requirement under the general permission

63. The degree of nexus, or connection, required to satisfy each of the two limbs of deductibility (s DA 1(1)(a) and s DA 1(1)(b)) is the same, although it is measured in different contexts, non-business and business (*NRS Media Holdings v C of IR* (2018) 28 NZTC 23,079 (CA)).
64. To determine whether there is a sufficient nexus between expenditure and an income-earning process of the taxpayer's, it is necessary to ascertain the true character of the expenditure and consider the relationship between the advantage the taxpayer was seeking to gain from the expenditure and the taxpayer's income-earning process. See, for example, *CIR v Banks* [1978] 2 NZLR 472 (CA) and *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271 (CA).
65. Whether there is a sufficient nexus between the expenditure and the income-earning process depends on the particular facts. But it is clear that it is necessary to consider the factual situation **at the time the expenditure was incurred**, which is when the taxpayer has become definitively committed to the particular item of expenditure. This was noted in *Banks* (judgment delivered by Richardson J at 477):

> The statutory requirement is that the expenditure be "incurred in gaining or producing the assessable income". **That has to be judged as at the time that the taxpayer became definitively committed to the expenditure for which deduction is sought** …
>
> …
>
> **It then becomes a matter of degree, and so a question of fact, to determine whether there is a sufficient relationship between the expenditure and what it provided, or sought to provide, on the one hand, and the income earning process, on the other, to fall within the words of the section**.
>
> [Emphases added]

66. Importantly for present purposes, income does not need to be produced in the year in which the expenditure is incurred. Expenditure may be incurred before or after the derivation of the income it relates to. As long as there is a sufficient connection between the expenditure and the taxpayer's income-earning activity, the expenditure will satisfy the nexus requirement for deductibility. This is clear from *Eggers v CIR* [1988] 2 NZLR 365 (CA), where the court said from 372:

> While for fiscal and administrative reasons income tax is calculated on annual income, the tax system must recognise the continuing nature of much business and other income earning activity. It does so in numerous ways and both limbs of sec 104 [now s DA 1(1)] also reflect that reality in linking deductibility to gaining or producing the assessable income "for any income year". That clearly covers the case of a continuing business or existing income earning activity.
>
> …
>
> … **In short, an expenditure may precede or succeed related income so long as, applying the general tests under the respective limbs, there is a sufficient nexus between expenditure and income earning activity**. …
>
> [Emphases added]

67. In *Slater v CIR* [1996] 1 NZLR 759 (HC), Fisher J also noted that income does not need to be derived in the year the expenditure is incurred. Provided the purpose of the expenditure is the production of assessable income and there is the required nexus between the activity in respect of which the deduction is claimed and intended income, the expenditure will be deductible (subject to any required apportionment, the general limitations, and any other rules in the Act). Fisher J commented at 767:

> … It has been consistently held that to qualify as a deductible activity for the purpose of provisions of that kind two conditions must be satisfied: first the purpose of the expenditure, interest or use of an asset must be the production of income and secondly there must be some reasonable nexus between the activity in respect of which the deduction is claimed and the intended income. **But so long as those two conditions are satisfied, the deduction can be claimed in the year of the deductible activity without waiting**

> **for derivation of the proposed income**: *Eggers v C of IR* (1988) 10 NZTC 5,153; [1988] 2 NZLR 365 (CA) at NZTC pp 5,160, 5,161; NZLR p 373, *Ward & Co Ltd v Commissioner of Taxes* [1923] AC 145 at p 148, *Hugh v Bank of New Zealand* (1938) 21 DC 472 at p 524, *Ash v C of T (SW)* (1938) 61 CLR 263 at p 272.
>
> [Emphasis added]

Relevance of the use of the land

68. To determine whether there is a sufficient nexus between holding cost expenditure and the taxpayer's income-earning process, it is necessary to identify the advantage the taxpayer was seeking to gain from the expenditure.

69. The **use to which land is put** is relevant in determining whether holding costs satisfy the nexus requirement in s DA 1. As explained from [70], this is true for interest as well as other holding costs.

70. Interest is paid for the use of money. The advantage obtained from the payment of interest is the use of borrowed money. Where borrowed money is used to acquire land, whether the interest is (on the face of it)[10] deductible depends on the use to which the land is put in the period in which interest is incurred (*Pacific Rendezvous*).

71. Liability to pay rates arises as an incident of the ownership or occupation of land (*Bryan v Opotiki District Council* (HC, Tauranga CIV-2006-470-703, 26 September 2006)). In *Australian National Hotels Ltd v FCT* 88 ATC 4627 (FCFCA) Bowen CJ and Burchett J commented that the advantage sought during recurring periods of insurance is the continued availability of the asset that is insured. Similarly, repairs and maintenance and body corporate levies (which fund things such as maintenance and insurance for common areas) provide the advantage of the continued use and enjoyment of the property.

72. As such, for taxpayers who are not companies, the same statutory test applies to all land holding costs, and the same factual matters (the use to which the land is put during the period in which expenditure is incurred) are relevant in determining whether and the extent to which holding cost expenditure satisfies the general permission in s DA 1. This is consistent with *Case J66* (1987) 9 NZTC 1,393 and *Case M46* (1990) 12 NZTC 2,280 (which were decided after *Pacific Rendezvous*), in which the Taxation Review Authority applied the same test to all holding costs.

73. This Interpretation Statement assumes the taxpayer is not a company, so s DB 7 will not be relevant to interest deductibility.

Use (or uses) of land taxed on sale

74. As the **use to which land is put** determines whether holding costs satisfy the general permission for deductibility, the question then is: what is the use (or are the uses) of land that is taxed on sale?

75. Because holding costs are (generally)[11] deductible as they are incurred (if they are deductible),[12] the use or uses of the land need to be considered in each income year, as the use of the land may change from one year to the next.

Non-physical uses of the land are relevant

76. The use of land generally means the physical use or occupation of the land (*Brake v Inland Revenue Commissioners* [1915] 1 KB 731 and *Thornton Estates Ltd v CIR* (1998) 18 NZTC 13,577 (CA)). However, land may also be used without being physically used. Holding land for resale is a use of land. The land is being held as a means of achieving something – a profit on sale. As the Court of Appeal said in *Sloss v Sloss* [1989] 3 NZLR 31 at 36:

> The physical occupation of property is clearly a use of that property. In its ordinary meaning, "use" is not, however, confined in that way. In its natural meaning it is a word of wide import. … **The owner of land may be said to use the land when, without doing anything on that land, he obtains advantages from the land** (*Newcastle City Council v Royal Newcastle Hospital* [1959] AC 248, 255) and in *R v Heyworth* (1866) 14 LT 600, 601 Lush J observed that: "The owner 'uses' the place [a slaughter house] by letting it out". Even the giving away of property may be a "use" of that property (*R v Wampole (Henry K) & Co* [1931] 3 DLR 754)).
>
> [Emphasis added]

Multiple concurrent uses of land

77. It is also clear that land can be used concurrently by more than one person; for example, by the owner of the premises and by someone leasing the premises (*FCT v Tourapark Pty Ltd* (1980) 33 ALR 153 (FCAFC) and *Ryde Municipal Council v. Macquarie University* (1978) 23 ALR 41 at 45 (FCHCA)).

10 Note that the interest limitation rules in subpart DH may apply to disallow (or partly disallow) interest deductions.

11 But see footnote 25 on page 33. Note also that s EA 3 (Prepayments) may potentially be relevant to insurance premiums – see [48].

12 Note that the interest limitation rules in subpart DH may apply to disallow (or partly disallow) interest deductions.

78. Similarly, land can be used concurrently by one person for more than one purpose; for example, it can be held for resale (which is an income-earning use if the sale will be taxable) and also used privately by the owner during the period of ownership (for example, if it is used by the owner for holidays).

Holding land on revenue account is an income-earning use of the land

79. Several provisions in the Act mean land is held on revenue account, so the amount derived on its disposal will be income. Where this is the case, one use of the land is that it is being held for taxable sale. For example, land will be on revenue account from the time it is acquired if:
    - it was acquired for a purpose or with an intention of disposal (s CB 6), and no exclusion is available;
    - at the time the land was acquired the taxpayer or an associated person was in the business of dealing in land, or developing or subdividing land, and the land was acquired for the purpose of the business (s CB 7), and no exclusion is available.

80. Land may also move from being held on capital account to being held on revenue account at some time during the ownership period. This would be the case once the criteria for the eventual disposal of the land being taxed have been met, for example, if:
    - within 10 years of acquiring land, the taxpayer starts an undertaking or scheme involving more than minor development or division of the land (s CB 12), and no exclusion is available;
    - the taxpayer carries on an undertaking or scheme involving significant expenditure on development or division work in relation to land, and no exclusion is available.

81. During some or all of the period land held on revenue account is owned, it may also be used to earn current year income or used privately or both. Therefore, at any time, the land may be used for multiple simultaneous or concurrent uses.

Holding land on capital account is not income-earning use of the land, even if the disposal of the land ends up being taxed

82. In other situations, land is held on capital account but its disposal ends up being taxed (for example, land taxed under the bright-line test (s CB 6A or s CZ 39) or under one of the 10-year rules (ss CB 9 to CB 11)).

83. In the Commissioner's view, it cannot be said that in these situations a use of the land was that it was held for income-earning sale. During the ownership period, there is not sufficient certainty the sale of the property will end up giving rise to income (being taxed) – there is just a possibility that it would.

84. There is in a sense a relationship between holding costs incurred and the earning of income on sale. Holding costs are incurred over the same period as the increase in value of the land occurs, so it can therefore be argued that holding costs are necessarily incurred in deriving the income.

85. However, the nexus required to meet the general permission is between the expenditure and an income-earning process. A benefit that is too remote or indirect will not satisfy the nexus test. Crucially here, the property is not committed to an income-earning activity of taxable sale during the period of ownership. There is merely the **potential** during the relevant period (for example, 5 or 10 years) for the ultimate sale to be taxed.

86. The Commissioner does not consider that there is a sufficient nexus between expenditure on holding costs and an income-earning process if there is no current year (or anticipated) income-earning use of the land (for example, rental use), just the possibility that the land will be taxed when sold. As Judge Barber noted in *Case T16* (1997) 18 NZTC 8,095, while income need not be received in the same period, there must be an **expectation** that income will be received (at 8,097):

    > For interest to be deductible the borrowed funds must be *used* **to seek assessable income** (for any year) in the period in which the deduction is sought ie in general terms, expenditure must be in the course of business rather than preparatory to commencement of business. It is not necessary for income to be received in the same period, but **there must be an expectation that income will be received** — *Eggers v C of IR*.

    [Bold emphases added]

87. It has been suggested that because there will generally be an expectation that land will increase in value, there is a nexus between holding cost expenditure and expected profit. It is submitted that the fact a person does not know the profit will be taxable should not mean the nexus requirement for deductibility is not met; it is just not known what the tax implications will be (that is, whether the profit will be income or capital).

88. While s DA 1 does not contain a temporal requirement (that is, the income to which the expenditure relates does not need to be derived in the same income year), the advantage the taxpayer seeks to gain from the expenditure has to be

the derivation of assessable income or excluded income or a combination of the two. That is, there has to be a sufficient relationship between the expenditure and the taxpayer's business or other income-earning process.

89. If land is not part of or committed to an income-earning process, the Commissioner considers that expenditure in relation to the land cannot have the requisite nexus with an income-earning process. The fact the Act may bring what would otherwise be a capital receipt in as income does not alter what it was that the taxpayer was seeking to gain from incurring the expenditure. The requirements for deductibility are tested at the time expenditure is incurred and this is (subject to any specific timing rule) when the expenditure is deductible. Deductibility turns on the facts at that time (as noted in *Banks* – see [65]), not what subsequently transpires.

90. Therefore, where land is held on capital account but ends up being taxed on sale, it cannot be said that a use of land was that it was held for income-earning sale. The only basis for deductibility under s DA 1 of holding costs for land held on capital account (where there is no certainty that the disposal will be taxed, although this may subsequently turn out to be the case) is there being some current year (or anticipated) income-earning use of the land. However, there may be situations where the Commissioner would accept holding costs being deducted[13] because it is expected that the sale of land held on capital account will be taxed – this is discussed from [92].

91. If there is anticipated income to be derived from the property (for example, the property is advertised as available for rent, but not actually rented during the year), the nexus requirement in s DA 1 may be satisfied. However, the taxpayer would be expected to be able to show they had a genuine expectation that income would be earned. This may require the taxpayer to demonstrate that the property was genuinely available for rent; for example, by providing evidence of active and regular marketing of the property at market rates and that the property is available at times and for periods that show it is genuinely available to rent.

92. The Commissioner would accept that holding costs for land held on capital account are deductible (subject to any required apportionment and to the interest limitation rules) from the time a binding contract for the sale of land is entered into, if in the circumstances that means the sale will be taxed.[14] For example, the Commissioner would accept holding costs being deducted[15] from the time a binding contract for the sale of residential land within the relevant bright-line period has been entered into, if no exclusion from the bright-line test applies so the sale will be taxed.

93. There may be situations where the Commissioner would accept that holding costs for land held on capital account are deductible[16] from an earlier point in time that is reasonably close to when a binding contract for (taxable) sale is entered into. The Commissioner would expect the taxpayer to be able to show actions they had taken that evidence they were committed to selling the property and had a genuine and reasonable expectation from that time that the sale would be taxed. Whether a taxpayer can show this will be highly fact-dependent.

Vacant periods

94. There is a question as to what the use or uses of land are during periods it is physically unused or vacant. This issue arises only where the MUA rules do not apply. If the MUA rules apply, it is only the active uses of the asset that are relevant (see from [114]).

95. The Commissioner does not consider there is necessarily an element of private use of a land during periods of vacancy by virtue of the property being available for private use. However, as noted at [76], land may be used without being physically used. The question then is whether property can be considered to be used privately in a non-physical or non-active sense (that is, in vacant periods).

96. In the Commissioner's view, this comes down to an assessment of what 'use' of an asset in a particular way entails. Private use of land does not necessarily require physical presence. For example, if a person is away on holiday for two weeks there is no question their home is still being used privately by them in their absence and property-related expenditure would be of a private or domestic nature. Similarly, if someone had a home in a rural area and also an apartment in the city that they stay at during the work week, the Commissioner considers that there would be private use of the apartment every day not just on days the taxpayer is staying there. In this situation, the apartment is being held and maintained essentially as a second home. Normal use of a home (or second home) involves periods of absence from the home.

13 Subject to any required apportionment and to the interest limitation rules.

14 Even though there is not *complete* certainty the vendor will derive income (for example, if the contract is cancelled in circumstances where the deposit is not retained by the vendor).

15 Subject to any required apportionment and to the interest limitation rules.

16 Subject to any required apportionment and to the interest limitation rules.

97. The Commissioner considers that whether a property is being used (or partially used) privately in any vacant period will be highly fact-specific and requires considering the overall circumstances.

98. It should be noted that *de minimis* or incidental private use can be ignored. For example, in *Commissioner of Taxation v Dixon Consulting Pty Ltd* (2006) ATC 4832; (2006) 65 ATR 290; [2006] FCA 1748, Emmett J indicated that private use could be fairly characterised as *de minimis* if it were "so slight that it should be ignored". And in *CIR v Haenga* [1986] 1 NZLR 119 (CA), the taxpayer's (compulsory) contributions to a welfare fund were held not to be of a private or domestic nature, with Richardson J commenting (at 128) that "any personal satisfaction derived from membership of the welfare society and the availability of benefits is only an incidental effect of the expenditure". If there is *de minimis* private use of a property only, there is no question of there being any non-physical or non-active private use of the property during vacant periods.

99. If there is considered to be private use during any vacant periods and there is also income-earning use in those periods (for example, because the property is held on revenue account or because it is genuinely available for rent), apportionment would be required for those periods (see from [101]).

100. To the extent any statements or conclusions in QB 19/08: *How do the standard income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately?* (Inland Revenue, May 2019) are inconsistent with the discussion from [94], QB 19/08 is superseded by this Interpretation Statement. In particular, QB 19/08 indicates that full deductibility is allowed for nights a dwelling is rented out or available to be rented out. However, if there is considered to be private use in the periods of vacancy (as discussed above), the Commissioner considers that apportionment would be required for those periods.

Whether apportionment is required, with holding cost expenditure being only partly deductible

Whether apportionment is required

101. As noted at [54], the general permission in s DA 1 (set out at [57]) only allows for deductibility *to the extent* expenditure satisfies the nexus requirement. The private limitation (s DA 2(2)) also requires apportionment, denying deductibility *to the extent* expenditure is of a private or domestic nature. Section DA 2(2) provides:

> **DA 2 General limitations**
>
> ...
>
> *Private limitation*
>
> (2) A person is denied a deduction for an amount of expenditure or loss *to the extent to which* it is of a private or domestic nature. This rule is called the **private limitation**.
>
> [Italicised emphasis added]

102. It is clear that ss DA 1 and DA 2(2) contemplate apportionment. A deduction is potentially allowable only to the extent that the general permission is satisfied and the private limitation does not apply. This is true of all expenditure, including expenditure that serves both income-earning and other purposes indifferently (*Banks*, *Buckley & Young* and in *CIR v Atlantic & Pacific Travel International Ltd* (1993) 15 NZTC 10,024).

103. Some holding costs for a residential property are fixed regardless of whether the taxpayer uses the property for private purposes. The fact expenditure is fixed regardless of whether (or the extent to which) property is used for private purposes does not mean apportionment is not required. Apportionment of fixed costs is required if part of the costs are attributable to a private objective (*CIR v Eales* (1987) 9 NZTC 6,203 (HC)).

104. In *Pacific Rendezvous*, borrowed money was used for both a capital purpose (to increase the capital value of the assets for sale) and an income-earning purpose (to increase the profitability of the business in the meantime). The court held that the interest was fully deductible because while there were two simultaneous uses of the property, the borrowed money was at all times employed in producing income. The use of the asset for capital purposes was disregarded as not being a "competing use".

105. The two uses of the borrowed funds in *Pacific Rendezvous* were income-earning and capital. However, the Commissioner took the view in IS0082: *Interest deductibility* – Public trustee v CIR (Inland Revenue, May 2006) that *Pacific Rendezvous* states a broader principle, and is authority for interest being fully deductible where all of the borrowed funds are used in an income-earning activity, despite the interest also having some other use – whether capital or private.

106. The Commissioner no longer considers that correct and is now of the view that *Pacific Rendezvous* is **not** authority for interest being fully deductible where land is used both privately and for income-earning.

107. This is because in *CIR v Brierley* [1990] 3 NZLR 303 (CA), the court (judgment delivered by Richardson J) clarified that the capital use of borrowed money was not regarded as a "competing use" because the allowance of a full deduction for interest where a capital asset is used simultaneously for both income-earning and capital purposes is consistent with the scheme of the legislation. The court in *Brierley* considered that Parliament must have recognised that a capital asset used in producing assessable income may also produce capital gains or returns. However, the legislation permits a deduction for the cost of the use of capital and does not deny a deduction for interest on capital used in producing income because of the existence of actual or prospective capital gains or returns. This reasoning does not apply where there are both income-earning and private uses of the asset acquired with the borrowed money.

108. Section DB 6, which was enacted as part of the rewriting of the Income Tax Act, clarifies the relationship between s DB 6, the general permission, the capital limitation and the private limitation in a way that is consistent with the above view. As s DB 6 overrides the capital limitation, a deduction for interest is allowed if the general permission is satisfied and a deduction for interest could not be disallowed on the basis that the borrowed money is used to produce both income and capital gains or returns (s DB 6(4)). However, the private limitation still applies to interest.

109. For these reasons, the Commissioner no longer considers that *Pacific Rendezvous* is authority for interest being fully deductible where all of the borrowed funds are used in an income-earning activity, despite also serving some other purpose – irrespective of the nature of that other purpose. This Interpretation Statement supersedes the comments to that effect in IS0082.

110. The Commissioner considers that *Brierley* confirms that the principle in *Pacific Rendezvous* applies only where the other use of the borrowed money is a capital use. The Commissioner's view is that if there are simultaneous uses of borrowed money, and one of those is a private use, apportionment is required and any interest deduction available is disallowed to the extent of the private use.

111. Therefore, if land has been used for some or all of the time for private use, it is necessary to apportion land holding cost expenditure (including interest, if otherwise deductible), with the expenditure being deductible in part only.

How holding cost expenditure should be apportioned where there are different uses of land

112. Because holding costs are (generally)[17] deductible as they are incurred (if they are deductible),[18] the use or uses of the land need to be considered in each income year, as the use of the land may change from one year to the next.

113. If there is income-earning use of land (including where no income has been received but the property is committed to an income-earning process and income is expected to be derived), the extent to which holding costs are deductible depends on whether there are other uses of the land (for example, private use), and if so, whether the MUA rules apply.

Whether the MUA rules apply

114. The MUA rules apply where an asset (including land) is, in an income year:
    - used privately (this includes use by natural person associates, or by anyone renting it out for less than 80% of the market value rent);
    - used to derive income; and
    - unused for at least 62 days.

115. "Use" in the MUA rules is defined as "the active use of the asset for its intended purpose" (s DG 3(7)). Active use of land for its intended purpose would include use such as a dwelling being used for accommodation, fruit trees being grown and tended to in an orchard, or a parking lot being used for car parking. If land is held on revenue account or otherwise committed to an income-earning process but not actively used to earn income (such as rental income), that use is not considered an income-earning use in terms of whether the MUA rules apply.

116. If the criteria at [114] are met, in two situations a taxpayer can opt out of the MUA rules for the asset (s DG 21). These situations are:
    - where the gross income from the property for the year is under $4,000; or
    - where the taxpayer would otherwise have quarantined expenditure under the MUA rules for the year.[19]

17 But see footnote 25 on page 33. Note also that s EA 3 (Prepayments) may potentially be relevant to insurance premiums – see [48].

18 Note that the interest limitation rules in subpart DH may apply to disallow (or partly disallow) interest deductions.

19 This will be the case if the income from the property for the year is less than 2% of the property's value and the deductible expenses for the property under the MUA rules exceed the income (s DG 16).

117. For further guidance on determining whether the MUA rules apply, see QB 19/06: *What income tax rules apply if I have a dwelling that I sometimes rent out as short-stay accommodation and sometimes use myself?* (Inland Revenue, May 2019).

If the mixed-use asset rules apply

118. Where the MUA rules apply, they prescribe:
    - which expenses are fully deductible (certain expenses that relate solely to the derivation of income); and
    - the basis for apportionment for all other deductible property-related expenses (other than capital expenses, which may be deductible under s DB 23 if the property is subject to tax on sale).

119. Some holding cost expenditure may be fully deductible under the MUA rules; for example, additional rates or insurance premiums paid (over and above what would otherwise be payable) because the property is rented out. However, other than expenditure of that nature, if the MUA rules apply, land holding costs are apportioned under the formula in the MUA rules.[20]

120. The formula takes into account the number of "income-earning days". These are (relevantly) the days in the year for which the owner derives income from the "use" of the asset.

121. As noted at [115], use is defined in the MUA rules as "the active use of the asset for its intended purpose". Therefore, if the MUA rules apply, the apportionment will take into account only days the property is actively used to earn income (for example, days the property is rented out). If the land is held for income-earning sale, that is not a relevant use of the land for the apportionment formula.

122. The effect of the formula is that holding cost expenditure is apportioned based on the number of income-earning days divided by the number of income-earning days plus "counted days" (days the asset is in use that are not income-earning days). For example, if a property is rented out for 100 days in the year and used privately for 50 days, two thirds of the expenditure subject to apportionment under the formula (including holding costs) is deductible (100 income-earning days divided by 150 income-earning days plus counted days).

123. The MUA rules, and the definitions of the above terms, are discussed in detail in QB 19/07: *How do the mixed-use asset income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately?* (Inland Revenue, May 2019).

124. However, since the publication of QB 19/07, additional rules have been enacted that mean interest deductions for many residential properties will no longer be available. These rules are in subpart DH and mean interest deductions are:
    - denied for residential properties purchased on or after 27 March 2021, unless an exclusion or exemption applies;
    - progressively phased out for residential properties purchased before then, unless an exclusion or exemption applies; and
    - not allowed from 1 October 2021 for new borrowings drawn down on or after 27 March 2021.

125. Interest may, therefore, need to be considered separately from other holding cost expenditure. This is the case even where the MUA rules apply, as the interest limitation rules in subpart DH override the MUA rules (s DG 2(3B)). QB 19/07 should be read subject to the interest limitation rules in subpart DH.

126. Interest deductions that would have been allowed if not for the interest limitation rules in subpart DH may become deductible if the land is sold and the sale is taxed (s DH 11). See further from [172].

127. Further information about the interest limitation rules is on Inland Revenue's website.[21]

If the mixed-use asset rules do not apply

128. If there is income-earning use of land (including where no income has been received but the property is committed to an income-earning process and income is expected to be derived) and private use of the land and the MUA rules do not apply, general apportionment principles should be used to determine the extent to which holding cost expenditure is deductible.

129. The purpose of apportionment is to ascertain how much of the expenditure is attributable to the deductible item (income-earning use) and how much is attributable to the non-deductible item (in this instance, private use). Apportionment must

20 This Interpretation Statement assumes the taxpayer is not a company. This means the special rules that apply if a mixed-use asset is owned by a company (ss DG 10 to DG 14) do not apply.

21 For example, Property interest limitation rules (webpage, Inland Revenue, last updated 5 July 2022) or search the Inland Revenue website for "interest limitation rules".

be fair and not arbitrary. The circumstances of a particular case will determine the most appropriate way of ascertaining how much of the expenditure is attributable to the deductible compared with non-deductible uses. See for example *Buckley & Young*.

130. Apportionment for land held on revenue account (that is, held for taxable sale) is discussed from [131]. Apportionment for land held on capital account (that is, not held for taxable sale) is discussed from [143].

Land held on revenue account (that is, held for taxable sale)

131. If land is held on revenue account (for taxable sale), used privately, but not actively used to earn income (for example, rental income), the MUA rules will not apply (see [115]).

132. It would not be a common scenario, but it is possible that land could be held on revenue account, used to earn current year income, used privately during the year, and the MUA rules not apply (other than because of opting out).

133. In either of these scenarios, in some periods there will be simultaneous income-earning use (being held for taxable sale) and private use. In the second scenario, in other periods there will be simultaneous income-earning uses (being held for sale and being used to earn current year rental or other income).

134. There is a question as to how holding cost expenditure should be apportioned for periods where there is simultaneous income-earning use (being held for taxable sale) and private use.

135. There are several possible approaches to apportionment where there are simultaneous income-earning and private uses of land.

136. The purpose of apportionment is to ascertain how much of the expenditure is attributable to the deductible items compared with the non-deductible items (in this case, uses of the land). Apportionment must be fair and not arbitrary, and the circumstances of a particular case determine the most appropriate method of apportionment.

137. In the Commissioner's view, 50:50 is generally an appropriate starting point for apportionment for periods of simultaneous income-earning use (because the land is held for taxable sale) and private use. The provisions that mean land will be on taxable on sale do not require a dominant purpose of disposal, and it is difficult to see (absent a particular factual situation) how either the income-earning use or the private use could be considered a more dominant or important use. However, the Commissioner would accept any other basis for apportionment that is fair and reasonable in a taxpayer's particular circumstances.

138. In periods the property is vacant or physically unused, the property is used for income-earning as it is committed to an income-earning process, being held for taxable sale. Whether holding costs are fully-deductible for these periods depends on whether there is considered to be non-physical or non-active private use of the property. This will be highly fact-specific. See further from [94].

<u>The interest limitation rules</u>

139. If part of the holding cost expenditure for land is interest, it is necessary to apply the interest limitation rules in subpart DH to determine the amount of interest (if any) that can be deducted (subject to apportionment) – see from [124].

<u>The ring-fencing rules</u>

140. If, after appropriate apportionment, the allowable deductions for the property (or portfolio of properties it is part of) exceed income from the property (or portfolio) for the year, the ring-fencing rules in subpart EL may apply to limit the amount of deductions that can be taken in the current year (with any excess being carried forward).

141. The ring-fencing rules do not apply to assets in the MUA rules (s EL 12), but the situation we are considering here is one where the MUA rules do not apply.

142. The ring-fencing rules also do not apply if the exclusion for land held on revenue account is satisfied (s EL 10). But note that in some situations (for example, for land that is held on revenue account because it was acquired with the intention of resale) the taxpayer needs to have notified the Commissioner that the property is held on revenue account – which, depending on the circumstances, may need to be done by the return filing date for the year the property was acquired. If the requirements for the exclusion for land held on revenue account have not been met, the ring-fencing rules may also need to be considered.[22]

22 While less likely, the main home exclusion from the ring-fencing rules could potentially apply here (see s EL 9).

Land held on capital account (that is, not held for taxable sale)

143. In situations where land is held on capital account (that is, not held for taxable sale) and there are both income-earning and private uses of the property but the MUA rules do not apply (other than because of opting out), a time-based or time- and space-based apportionment of holding costs between the current year income-earning use and the private use of the property is appropriate.

144. For example, if a bach not held for taxable sale is sometimes rented out and sometimes used privately, but the MUA rules do not apply (for example, because the bach is unused for less than 62 days in the income year), a time-based apportionment is generally appropriate. Deductible holding costs[23] are fully deductible for periods the property is rented out, subject to any space-based apportionment required (for example, if people renting the property out cannot use some areas). Holding costs are not deductible for periods of private use or periods the property is not available to be rented out. Deductibility for periods the property is vacant depends on whether the property is genuinely available to be rented out and whether there is considered to be non-physical or non-active private use of the property. This will be highly fact-specific. See further from [94].

145. For further guidance on how to apportion holding costs (and other expenditure) in this situation, see QB 19/08.

146. In some situations, a property may be used for income-earning (for example, rental) and simultaneously for private use; for example, if a taxpayer occasionally rents out a room in their house for short-stay accommodation and the guests can use common areas such as the lounge, kitchen and bathroom.

147. For guidance on how to apportion holding costs (and other expenditure) in this situation, see *QB 19/05: What are my income tax obligations if I rent out my home or a separate dwelling on my property as short-stay accommodation?* (Inland Revenue, May 2019).

148. If there is no current year income but there is anticipated income-earning use of the property (for example, the property is advertised as available for rent, but is not actually rented during the year), the nexus requirement in s DA 1 may be satisfied (see [91]), allowing holding costs to be deducted for those periods. In this scenario, the interest limitation rules in subpart DH (see [124]) need to be considered in respect of interest. Any interest denied under subpart DH may become deductible on taxable sale of the land (see from [172]).

149. If land is held on capital account but ends up being taxed on sale (for example, under the bright-line test), this does not generally alter the approach to apportionment of holding costs. As discussed from [82], land that is held on capital account is not committed to an income-earning activity of taxable sale during the period of ownership, though it may transpire that the sale ends up being taxed. As such, the fact the property ends up being taxed on sale is not factored into the apportionment of holding cost expenditure – it does not alter what it was that the taxpayer was seeking to gain from incurring the expenditure. And as noted at [88], the requirements for deductibility are tested at the time expenditure is incurred.

150. However, the approach to apportionment of holding costs would differ for any period of the taxpayer's ownership it can be shown there was a genuine and reasonable expectation that the sale would be taxed (see from [92]). If there is any private use of the property during this period, the Commissioner would accept a 50:50 apportionment as a starting point, and full deductibility for any time in this period there is no private use. But if either the income-earning use or the private use were more dominant or important, this apportionment should be adjusted to reflect that.

The interest limitation rules

151. The interest limitation rules noted at [124] have been introduced since the publication of QB 19/08 and QB 19/05. These rules mean interest deductions for many residential properties will no longer be available (though it is noted that these rules do not apply to the extent land is a person's main home). Interest may therefore need to be considered separately from other holding cost expenditure.

152. Interest deductions that would have been allowed if not for the interest limitation rules in subpart DH may become deductible if the land is sold and the sale is taxed (s DH 11). See further from [172]. This means that (appropriately apportioned) interest deductions that have been denied only because of the rules in subpart DH may become deductible if land held on capital account ends up being taxed on sale (for example, under the bright-line test). But the taxable sale of land held on capital account will not alter the apportionment – that is, the fact that the sale has been taxed is not relevant to the apportionment between income-earning and private use, so has no bearing on the amount of interest that may

23 Noting that the interest limitation rules may mean some or all interest is not deductible.

become deductible on taxable sale. Nor will the fact the land ends up being taxed on sale alter the apportionment of other holding costs (for example, rates and insurance) that have been deductible – that is, the fact that it transpires that the sale is taxed will not allow a greater proportion of those costs to be deducted.

The ring-fencing rules

153. There is another set of rules that have been introduced since the publication of QB 19/08 and QB 19/05 – the ring-fencing rules in subpart EL. The ring-fencing rules limit the deductions that can be taken in any year that deductions for residential property exceed income from the property (or a portfolio of properties that the taxpayer owns). If allowable deductions exceed income from the property (or portfolio), the excess amount (over the amount of income) is carried forward for use in a future year where income is earned from the property or portfolio.

154. QB 19/08 and QB 19/05 should be read subject to the interest limitation rules in subpart DH and the ring-fencing rules in subpart EL.

If the mixed-use asset rules are opted out of

155. As noted at [116], a taxpayer can opt out of the MUA rules for an asset that would otherwise be in the rules in two situations. If a person opts out of the MUA rules, the income from the use of the asset is exempt income (s DG 21).

156. As noted at [115], use is defined in the MUA rules as "the active use of the asset for its intended purpose". This means only income from the active use of the asset (for example, rental) is exempt income. Any income from the sale of land (that is, if one of the land sale rules applies) is not exempt income.

157. Section DA 2(3) provides that a person is denied a deduction for an amount of expenditure or loss to the extent to which it is incurred in deriving exempt income.

158. If the land is held on capital account and is not sold in the year, the person cannot deduct any expenses for the property for that year. This is because all the expenses have been incurred in deriving only exempt income (s DA 2(3)).

159. If the land is held on capital account and is sold in the income year with the sale being taxed, the consequences are as follows:

- Interest deductions that have been disallowed during the period of ownership only by subpart DH (for example, in years the MUA rules were not opted out of) may be able to be deducted in the year of sale (see [174]).
- Holding costs other than interest incurred in any year the MUA rules were opted out of are not deductible because they were incurred in deriving only exempt income. This is not altered by the fact the sale of the property subsequently ends up being taxed – the nexus test between these costs and the income on sale would not have been met at the relevant time (when the expenses were incurred). The exception to this is holding costs incurred in any period there was a genuine and reasonable expectation the sale would be taxed.
- The deductibility of holding costs other than interest incurred in any year the MUA rules were not opted out of does not change. That is, the apportionment of those costs is not affected by the fact the sale of the property ends up being taxed.
- The cost of the property is deductible under s DB 23.

160. If a taxpayer has opted out of applying the MUA rules to land held on revenue account, holding costs are deductible subject to appropriate apportionment. This is because one of the uses of the land is that it is being held for taxable sale, so there is a sufficient nexus between the expenditure and the derivation of income from the taxpayer's income-earning process. However, apportionment is required because the property is also used to derive exempt income and used privately. The discussion on apportionment from [131] is relevant in this scenario, although the additional use of deriving exempt income also needs to be factored in.

Whether holding costs are part of the cost of the property, so deductible on taxable sale

161. The final issue for consideration is whether holding costs for land that is taxed on sale form part of the cost of the land, in which case they may be deductible under s DB 23. This is relevant to:

- the ability to deduct holding costs for land held on capital account that is not used to derive current year (or anticipated) income;
- the timing of deductions; and
- whether holding costs need to be apportioned on account of private use of the property.

162. Section DB 23 provides:

> **DB 23 Cost of revenue account property**
>
> *Deduction*
>
> (1) A person is allowed a deduction for expenditure that they incur as the cost of revenue account property.
>
> …
>
> *Link with subpart DA*
>
> (3) Subsection (1) supplements the general permission and overrides the capital limitation and the private limitation. Subsection (2) overrides the general permission. The other general limitations still apply.

163. Section EA 2 provides:

> **EA 2 Other revenue account property**
>
> *When this section applies*
>
> (1) This section applies to revenue account property that is not—
>
> (a) trading stock valued under subpart EB (Valuation of trading stock (including dealer's livestock)):
>
> ...
>
> *Timing of deduction*
>
> (2) A deduction for the cost of revenue account property of a person is allocated to the earlier of—
>
> (a) the income year in which the person disposes of the property; and
>
> (b) the income year in which the property ceases to exist.

164. Section EA 2 applies to land, as land is excluded from the definition of "trading stock" (s EB 2(3)(a)). Therefore, if holding cost expenditure forms part of the cost of land and the land is taxed on sale, the deduction (to the extent it is allowed) would be taken in the year of sale rather than in the year the expenditure is incurred.

165. The issue of whether holding costs form part of the cost of land is also relevant to the ability to deduct holding costs for land that is not used to derive current year (or anticipated) income, but that ends up being taxed on sale (for example, under the bright-line test). This is because s DB 23(1) supplements the general permission. Section DA 3(1) provides that if a provision supplements the general permission, the general permission does not need to be satisfied for the deduction to be allowed.

166. Section DB 23(1) also overrides the private limitation. This means that if holding costs form part of the cost of land, that expenditure would not need to be apportioned on account of private use of the property if the property is taxed on sale.

Meaning of "cost"

167. The Act does not define "cost" for the purposes of s DB 23. However, its meaning has been considered in numerous cases.[24]

168. The case law has established that:

- the word cost is capable of various meanings, depending on the context,
- cost means that which must be given in order to acquire something and has a wider meaning than payment on purchase, and
- in determining cost, a transaction must be viewed in its commercial reality, and some assistance may be derived from common business parlance and practice, including accepted accounting practice.

169. The Commissioner considers that, generally, the meaning of "cost" of revenue account property in s DB 23 is the commonly understood meaning of the term, being that which is given to acquire something. For land, this includes the initial outlay to acquire the land as well as the cost of capital improvements, as these form part of the land.

24 Including *Tasman Forestry Ltd v CIR* (1999) 19 NZTC 15,147 (CA), *CIR v Atlas Copco (NZ) Ltd* (1990) 12 NZTC 7,327 (HC), *PM Scientific Fur Cleaners Ltd v Home Insurance Co* (1970) 12 DLR (3d) 177 and *BP Refinery (Kwinana) Ltd v Federal Commissioner of Taxation* (1960) 12 ATD 204 (HCA).

170. The Commissioner does not consider that holding costs for land can generally[25] be considered to be part of the cost of the land. They are expenses incurred in relation to the ownership of land not its acquisition.

171. Therefore, as with any other deductions not subject to a specific timing provision, if holding costs are deductible they are (generally) deductible as incurred. As already discussed, deductibility depends on there being the requisite nexus with income (including anticipated income), and is subject to any required apportionment, the general limitations, the interest limitation rules and the ring-fencing rules.

Taxable sale of land – treatment of interest deductions disallowed by subpart DH, and the ring-fencing rules

172. If land is sold and the sale is taxed, interest deductions that would have been allowed during the ownership period if not for the interest limitation rules in subpart DH may become deductible (s DH 11).

173. However, the extent to which reinstated interest deductions or other deductions for the property can be allocated to the income year of sale may require consideration of the ring-fencing rules or the bright-line loss quarantine rule.

174. As explained below, the way the rules work depends on:

- whether the sale is taxed under the bright-line test or under one of the other land sale provisions, and
- how the ring-fencing rules have been applied (that is, whether to that property alone or to a portfolio of properties, and whether excess deductions have been transferred to the property or portfolio from another property or portfolio).

Previously denied interest deductions if the sale is taxed under the bright-line test

175. The amount of interest that would have been deductible in each year the property was owned **but for subpart DH**, is treated as part of the cost of the land for the purposes of s DB 23.

176. This means those deductions will become deductible on the taxable bright-line sale, subject to:

- the cost of the land (so the allowable deduction) needing to be reduced because there has been some main home use of the property (there is a formula for this in s DB 23C), and
- the bright-line loss quarantine rule in s EL 20.

177. For land in the 10-year bright-line test (or 5-year new build bright-line test), the amount of income from the sale is reduced (under s CB 6A(8)) if there has been some main home use of the land but the main home exclusion from the bright-line test (s CB 16A) is not available. This ensures the sale is not taxed to the extent the land was used as the taxpayer's main home. Section DB 23C correspondingly reduces the person's cost deduction to reflect that some of the cost of the property relates to the untaxed main home use.

178. For land in the old 5-year bright-line test (s CZ 39), there is no reduction for main home use of the land – the main home exclusion applies either in full or not at all.

179. The bright-line loss quarantine rule in s EL 20 applies if the property is sold at a loss. If this is the case, the deduction for the cost of the land that is allowed in the year of sale is limited to the person's land sale income. The effect of this is that the loss on the sale of the property does not reduce the person's taxable income (for example, if they have other income such as salary or business income). Any excess cost deductions that cannot be taken in the year of sale are carried forward and may be used against land sale income in the future.

Previously denied interest deductions if the sale is taxed under a provision other than the bright-line test

180. The amount of interest that would have been deductible **but for subpart DH** is allowed under s DH 11 as a deduction in the year of sale, but is subject to allocation under subpart EL (commonly known as the ring-fencing rules).

25 But see, for example, the legislative exception to this that may apply for interest deductions denied by the interest limitation rules, if the sale of the property is taxed under the bright-line test (discussed from [175]). Also, there may be circumstances where, for a period, some holding costs are capitalised for accounting purposes (see, for example, New Zealand Accounting Standards Board NZ IAS 23: *Accounting treatment for borrowing costs* (July 2007, incorporating amendments to 28 February 2018)). That may be a relevant consideration in terms of whether those costs should also be regarded as part of the cost of the asset for tax purposes.

The ring-fencing rules in the year of taxable sale

181. In the year of taxable sale, there may be ring-fenced deductions for the property (or a portfolio it was part of) from previous years that have not yet been allocated to an income year. Those ring-fenced deductions and deductions for the current year[26] are added together and allocated in accordance with the ring-fencing rules.
182. The starting point is that of those total deductions, an amount up to the amount of income from the property (or portfolio) can be claimed that year. This includes any net profit from taxed land sales in the year.
183. If after that there are still deductions remaining (that is, the past and current year deductions exceed the income from the property or portfolio), there are special rules that may allow those excess deductions to be un-ring-fenced. The way those rules work depends on whether the ring-fencing rules have been applied to that property alone, or to a portfolio of residential properties, and whether any excess deductions have been transferred to the property from other properties (and if so, whether those properties were taxed on sale).
184. If the ring-fencing rules have been applied to that property alone, the remaining ring-fenced deductions for the property become un-ring-fenced (so are allocated to the income year of sale), except to the extent of any deductions that have been transferred to the property from another property that was not taxed on sale. Any such transferred deductions remain subject to the ring-fencing rules and are carried forward and may be used in a future year.
185. If the ring-fencing rules have been applied to a portfolio of residential properties the property sold in the year was part of, the remaining ring-fenced deductions for the portfolio may become un-ring-fenced only if the property sold in the year is the last property in the portfolio to be sold and all the sales have been taxed. If that is the case, the remaining ring-fenced deductions would be un-ring-fenced except to the extent of any deductions that have been transferred to the portfolio from another property that was not taxed on sale. Any such transferred deductions remain subject to the ring-fencing rules and are carried forward and may be used in a future year.

26 Excluding interest deductions that become part of the land's cost, if the sale is taxed under the bright-line test.

Examples | Tauira

Example | Tauira 1 – Land held on revenue account and used privately

Note: this example only considers the deductibility of holding costs. Other approaches may be appropriate for any other deductible expenses.

Geraldine purchased an apartment in Wellington to use when she is there for work (three to five days a week), with the intention of reselling it for profit when her two-year contract ends.

In the income year in question, the apartment is used by Geraldine for a total of 192 days.

The MUA rules do not apply because there is no income-earning use that is recognised under those rules. Income-earning use for the MUA rules is the active use of the asset for its intended purpose (for example, rental use of the apartment would qualify, but Geraldine does not rent the apartment out).

For the whole year, the apartment is committed to an income-earning process, being held on revenue account (that is, for taxable sale). While this is not an income-earning use for the MUA rules, it is income-earning use in terms of satisfying the deductibility test.

The apartment is also considered to be used privately for the whole year, not just on the 192 days Geraldine was there. The apartment is being held and maintained essentially as a second home and normal use of a home (or second home) includes periods of absence.

Therefore, for the whole income-year there is simultaneous income-earning use (because the property is held on revenue account) and private use of the apartment. Geraldine considers that a 50:50 apportionment of holding costs is most appropriate. On this basis, any deductible holding costs will be 50% deductible.

The Commissioner would accept this basis for apportionment of Geraldine's holding cost expenditure. A taxpayer could apportion holding costs in other ways, depending on their particular circumstances. The important thing is that the method chosen represents a fair and reasonable weighing up of the relative importance of the income-earning and private uses.

Geraldine must apply the interest limitation rules in subpart DH to determine whether any interest she has incurred for the apartment is deductible (subject to the above apportionment).

The ring-fencing rules in subpart EL will not apply to limit the amount of deductions that can be claimed in this year if Geraldine has notified the Commissioner that the property is held on revenue account (see s EL 10(2) and (3)). But if she has not done this, the ring-fencing rules will need to be considered. If the ring-fencing rules apply and Geraldine's allowable deductions for the property (or a portfolio of properties) exceed income from the property (or portfolio) for the year, the rules will limit the amount of deductions that can be claimed in this year (with the excess being carried forward).

Any interest Geraldine would have been allowed to deduct (after appropriate apportionment on account of the private use of the property) were it not disallowed by the interest limitation rules will become deductible in the year Geraldine sells the apartment because the sale is taxed. This deduction[27] is subject to allocation under the ring-fencing rules.[28]

27 Plus any other deductions (other than the deduction for the (capital) cost of the property) Geraldine may have for the property (or portfolio) for the year.

28 Which would be relevant if the property was part of a not-fully-taxed portfolio or if any excess deductions had been transferred to the property from another property that was not taxed on sale.

Example | Tauira 2 – Land held on capital account, used privately and for rental, and taxed on sale under the bright-line test

Note: this example only considers the deductibility of holding costs. Other approaches may be appropriate for any other deductible expenses.

Jonathan owns a property in Queenstown that he rents out to tourists and also uses occasionally himself.

Year one:

In the first income year Jonathan owns the property, it is rented out for 315 days and used by Jonathan for 5 days. The property is vacant for 45 days. Jonathan had the booking calendar for 10 of the vacant days blocked out, as he was hoping to be able to make it to Queenstown in that period. The property was listed as available for rent at market rates for the other 35 days it was vacant.

The property was vacant for less than 62 days, so the MUA rules do not apply for this income year.

Jonathan must apply the interest limitation rules in subpart DH to determine whether any interest he has incurred for the property is deductible.

Any deductible interest and other holding costs are 100% deductible for the 315 days of the year the property was rented out and 35 of the 45 days it is vacant – when it was listed as available for rent at market rates. The only use of the property during those times is income-earning, as it is being used in an income-earning process (to earn rental income). The property is not considered to also be used privately in the vacant period that it is available for rent. Therefore, no apportionment is required for this period.

For the period of 10 days that the property is vacant and not available for rental (when the booking calendar is blocked) and the period of 5 days Jonathan uses the property, no holding costs are deductible. The property is not being used in an income-earning process in these periods.

If Jonathan's allowable deductions for the property (or a portfolio of properties) exceed income from the property (or portfolio) for the year, the ring-fencing rules in subpart EL may apply to limit the amount of deduction that can be claimed in this year (with any excess being carried forward). The ring-fencing rules will be relevant this income year because the property is not a MUA (see s EL 12).

Year four:

In the fourth year Jonathan owns the property, it is used or available for rent at all times and is not used by Jonathan. He sells the property a few months into the income year. The sale is taxed under the bright-line test.

Jonathan cannot deduct any additional amount of holding costs from the years he owned the property by virtue of the sale of the property being taxed.

However, any interest that Jonathan would have been allowed to deduct (after appropriate apportionment in each year he owned the property) were it not disallowed by the interest limitation rules will become deductible in the year Jonathan sells the property because the sale is taxed. Because the sale is taxed under the bright-line test, any interest that becomes deductible in the year of sale under these rules is added to the cost of the property. Provided the amount of income from the sale is more than the total cost of the property, the full cost deduction can be claimed that year.

References | Tohutoro

Legislative references | Tohutoro whakatureture

Sections CB 6A to CB 15, CB 16A, CZ 39, DA 1, DA 2, DA 3, DB 6, DB 7, DB 23, DB 23C, EA 2, EB 2, and subparts DG, DH and EL

Case references | Tohutoro kēhi

Australian National Hotels Ltd v FCT 88 ATC 4627 (FCFCA)

BP Refinery (Kwinana) Ltd v Federal Commissioner of Taxation (1960) 12 ATD 204 (HCA)

Brake v Inland Revenue Commissioners [1915] 1 KB 731

Bryan v Opotiki District Council (HC, Tauranga CIV-2006-470-703, 26 September 2006)

Buckley & Young Ltd v CIR (1978) 3 NZTC 61,271 (CA)

Case J66 (1987) 9 NZTC 1,393

Case M46 (1990) 12 NZTC 2,280

Case T16 (1997) 18 NZTC 8,095

CIR v Atlantic & Pacific Travel International Ltd (1993) 15 NZTC 10,024 (CA)

CIR v Atlas Copco (NZ) Ltd (1990) 12 NZTC 7,327 (HC)

CIR v Banks [1978] 2 NZLR 472 (CA)

CIR v Brierley [1990] 3 NZLR 303 (CA)

CIR v Eales (1987) 9 NZTC 6,203 (HC)

CIR v Haenga [1986] 1 NZLR 119 (CA)

Commissioner of Taxation v Dixon Consulting Pty Ltd (2006) ATC 4832; (2006) 65 ATR 290; [2006] FCA 1748

Eggers v CIR [1988] 2 NZLR 365 (CA)

FCT v Tourapark Pty Ltd (1980) 33 ALR 153 (FCAFC)

NRS Media Holdings v C of IR (2018) 28 NZTC 23,079 (CA)

Pacific Rendezvous Ltd v CIR [1986] 2 NZLR 567 (CA)

PM Scientific Fur Cleaners Ltd v Home Insurance Co (1970) 12 DLR (3d) 177

Ryde Municipal Council v. Macquarie University (1978) 23 ALR 41 at 45 (FCHCA)

Slater v CIR [1996] 1 NZLR 759 (HC)

Sloss v Sloss [1989] 3 NZLR 31 (CA)

Tasman Forestry Ltd v CIR (1999) 19 NZTC 15,147 (CA)

Thornton Estates Ltd v CIR (1998) 18 NZTC 13,577 (CA)

Other references | Tohutoro anō

Determination E12: *Persons excused from complying with section EA 3 of the Income Tax Act 2007* (Inland Revenue, March 2009)

IS0082: *Interest deductibility* – Public trustee v CIR (Inland Revenue, May 2006)

IS 12/03: *Income Tax – Deductibility of repairs and maintenance expenditure – General principles* (Inland Revenue, June 2012)

New Zealand Accounting Standards Board NZ IAS 23: *Accounting treatment for borrowing costs* (July 2007, incorporating amendments to 28 February 2018)

"Property held for resale: Tax treatment of costs of land development and other expenses", Public Information Bulletin No 179 (May 1989): 11

QB 19/05: *What are my income tax obligations if I rent out my home or a separate dwelling on my property as short-stay accommodation?* (Inland Revenue, May 2019)

QB 19/06: *What income tax rules apply if I have a dwelling that I sometimes rent out as short-stay accommodation and sometimes use myself?* (Inland Revenue, May 2019)

QB 19/07: *How do the mixed-use asset income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately?* (Inland Revenue, May 2019)

QB 19/08: *How do the standard income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately?* (Inland Revenue, May 2019)

TECHNICAL DECISION SUMMARY

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 23/13: Changing FIF calculation methods

Decision date | Rā o te Whakatau: 17 March 2023

Issue date | Rā Tuku: 17 October 2023

Subjects | Kaupapa

Changing FIF calculation methods; fair dividend rate method; comparative value method.

Taxation laws | Ture tāke

All legislative references are to Income Tax Act 2007 (the Act).

Facts | Meka

1. The Arrangement involves a Trust and a Company (the Applicants) seeking to change their foreign investment fund (FIF) calculation methods.
2. The Applicants have an interest in a number of foreign unit trusts and companies (the relevant FIFs). The relevant FIFs are not tax residents for New Zealand tax purposes under subpart YD and are not treated as being tax residents of New Zealand under any double tax agreement.
3. The Applicants have returned FIF income under the attributable FIF method (s EX 46(3)) in relation to their interests in the relevant FIFs from the beginning of their investment.
4. The assets of each FIF (or the FIF itself) have been sold. The Applicants have received distributions from the sale over two income years (the relevant income years).
5. The Applicants have not yet been required to file their tax returns for the relevant income years at the time of this ruling.
6. The FIF rules apply to the relevant FIFs as follows:
    - The rights held in the foreign unit trusts are each an "attributing interest" in a FIF under s EX 29 and none of the exemptions in ss EX 31 to EX 43 apply.
    - The rights are not exempt from being an attributing interest in a FIF under any of the categories listed in s CQ 5(1)(c).
    - The Applicants have not changed the FIF calculation method they each have used since the beginning of their investments in each FIF.
    - None of the requirements described in s EX 46(10) are met. Therefore, the interests held by the Applicants in the FIFs do not relate to a non-ordinary share.
    - The requirements of s CQ 5(5) are not met in relation to the Trust.
    - The Company is not required to use the fair dividend rate periodic method by s EX 52A(2).

Issues | Take

7. The issues considered in this ruling were:
   - whether the Applicants can change their FIF calculation methods for the relevant income years;
   - whether the Applicants can choose to use the fair dividend rate (FDR) calculation method to calculate their FIF income for the relevant income years; and
   - whether the comparative value (CV) calculation method is also available to the Trust for the relevant income years.

Decisions | Whakatau

8. The Tax Counsel Office (TCO) concluded that:
   - the Applicants can change their FIF calculation methods for the relevant income years;
   - the Applicants can choose to use the FDR calculation method for the relevant income years; and
   - the CV method is also available to the Trust.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: Changing FIF calculation method

9. Under s EX 62(1), once a person uses a particular calculation method to calculate FIF income for an attributing interest in a FIF for a particular period, they must use the same method for interests in the FIF for the next period unless they are allowed to change under subsections (2) to (9).
10. The relevant permission is s EX 62(3), which provides that a person may change methods by notice to the Commissioner if:
    - the notice complies with s EX 62(4); and
    - the change is to or from the attributable FIF income method and within subsections (6) or (7).
11. Section EX 62(4) includes three relevant requirements that the notice must:
    - give the reasons for the change; and
    - comply with the Commissioner's notice requirements; and
    - be given before the end of the first income year or accounting period for which the change is to take place, unless the Commissioner agrees to a retrospective notice.
12. TCO considered that the Applicants comply with s EX 62(3) for these reasons:
    - The Commissioner has accepted that this ruling application constitutes notice for the purposes of s EX 62(3) and this notice complies with s EX 62(4).
    - Section EX 62(6) is satisfied as the Applicants have only returned FIF income using the attributable FIF method, and this is the first time they have chosen to change from this method for the relevant FIFs.
13. Therefore, TCO concluded that the Applicants have met the requirements of s EX 62 and are able to change their FIF calculation methods for the relevant income years.

Issue 2 | Take tuarua: Availability of the FDR method

14. TCO considered whether the Applicants can choose to use the FDR method to calculate their FIF income for the relevant income years.
15. Section EX 46 is the main provision for the availability of different FIF income calculation methods.
16. Section EX 46(1) provides that if a person has two or more attributing interests in the same FIF for the same period, the person must use the same calculation method for calculating FIF income from each interest, unless the choice of method is limited by this section.
17. Under s EX 46(8), a person is not able to use the FDR method for an attributing interest in a FIF that is a share in a foreign company if:
    - the share is a non-ordinary share (s EX 46(8)(a)); and/or
    - the person chooses to use the CV method for another attributing interest that is a share in a foreign company for which the person would be allowed to use the FDR method (s EX 46(8)(b)).

TECHNICAL DECISION SUMMARY

18. For the purposes of the Act, the foreign unit trusts and the units in those trusts are foreign companies and shares respectively.
19. Given all attributing interests are shares in foreign companies, and the shares are not non-ordinary shares, TCO concluded that the Applicants can choose to use the FDR method in determining their income under the FIF rules for the relevant income years.

Issue 3 | Take tuatoru: Availability of the CV calculation method to the Trust

20. Under s EX 46(6), a person can use the CV method for an attributing interest in a FIF that is a share in a foreign company for an income year if certain criteria are met. As noted above, the attributing interests concerned are confirmed as shares in a foreign company.
21. To use the CV method, the Trust must meet at least one of the criteria in s EX 46(6)(a) – (e).
22. TCO considered that the Trust meets the criteria in s EX 46(6)(b) because, based on the facts in the ruling application:
    - The Trust is a New Zealand complying trust and has always been complying trust.
    - The Trust has no gifting settlor who is not a natural person or deceased person.
    - Since the Trust was established, it has been for the benefit of natural persons for whom the gifting settlors of the trust have natural love and affection.
    - The Trust is not superannuation scheme.
23. As a result, TCO concluded that the CV method would be available for the relevant income years.

Consequences of changing to the CV calculation method

24. If the Trust uses the CV method to calculate its FIF income in the relevant income years, the FIF income will be calculated in accordance with the formula in s EX 51:

    (closing value + gains) – (opening value + costs)
25. Relevantly, the definition of "opening value" in s EX 51(5) provides that the value is zero if the person was applying another calculation method to the FIF interest at the end of the previous income year.
26. Further, s EX 63 sets out the consequences for a person changing between a look-through method (attributable FIF income method) to a cost-based method (CV). Under s EX 63, the Trust will be treated as if:
    - it disposed of the interest to an unrelated person immediately before the start of the first relevant income year;
    - it reacquired the interest at the start of the first income year;
    - it received for the disposal and paid for the reacquisition, an amount equal to the interest's market value at the time.
27. As a result, for the first relevant income year:
    - The opening value of the Trust's relevant FIF interest is zero (s EX 51(5)).
    - The costs will include the market value at the start of the year (being expenditure that the person incurs in acquiring the interest) (s EX 51(6)(a)).

Application of s EX 46(1) and s EX 46(8)(b)

28. As mentioned in paragraph 16, a person must not use the FDR method to calculate FIF income if the person chooses to use the CV method for another attributing interest that is a share in a foreign company for which the person would be allowed to use the FDR method.
29. Given the Trust will be able to use either the FDR or the CV method to calculate its FIF income from the relevant interests, to ensure the ruling is consistent with ss EX 46(1) and EX 46(8)(b), the ruling is issued with the following proviso:
    - Where the Trust has two or more attributing interests in the same FIF in the same period, it uses the same calculation method for calculating the FIF income or loss from each interest in that FIF for that period (s EX 46(1)).
    - The Trust uses either the CV or the FDR method to calculate its FIF income for all the FIF interests in the relevant FIFs for each of the relevant income years (s EX 46(8)(b)).
    - If the Trust uses the CV method for determining its income under the FIF rules in the relevant income years, it does not use the FDR method in relation to any of its other FIF interests (s EX 46(8)(b)).
    - If the Trust uses the FDR method for determining its income under the FIF rules in the relevant income years, it does not use the CV method in relation to any of its other FIF interests (s EX 46(8)(b)).

LEGAL DECISION – CASE SUMMARY

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

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

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

CSUM 23/04: TRA finds disputant to be in a de facto relationship and upholds Commissioner's WfFTC assessments

Decision date: 17 October 2023

Case

TRA 005/21 [2023] NZTRA 1

Legislative References

Income Tax Act 2007, ss CB 32, MC 4, MC 7, MC 8, MC 11, YA 1 meaning of "de facto partner"

Legislation Act 2019, ss 13 and 14

Interpretation Act 1999, ss 4, 29 and 29A

Tax Administration Act 1994, ss 6 and 6A

Legal terms

De facto relationship; nature of marriage; working for families tax credits; entitlement

Date(s) heard

4 and 5 April 2022

Summary

The Taxation Review Authority (the **TRA**) upheld the Commissioner's assessments of the disputant's entitlement to Working for Families Tax Credits (**WfFTC**) at nil for each of the income years in dispute.

The disputant claimed WfFTC for the 2015 to 2018 income years on the basis she was a single parent. However, the Commissioner considered that the disputant was in a de facto relationship during the income years in dispute and so her partner's income should have been included as part of her family scheme income for WfFTC purposes. The effect of including the partner's income was that the disputant's entitlement to WfFTC was nil.

Impact

This decision considers the meaning of "de facto relationship" in the context of WfFTC.

Facts

The disputant claimed WfFTC in the 2015 to 2018 income years on the basis that she was a single parent. However, the Commissioner considered that she was in a de facto relationship with Mr X during those years and assessed the disputant's WfFTC entitlement to nil.

Reasons for why the Commissioner considered the disputant was in a de facto relationship included that she shared a residence with Mr X, there was financial interdependence between them, they holidayed together, Mr X described his marital status as de facto and listed the disputant as his next of kin contact.

The disputant was also found to have stolen funds from her employer in the 2016 to 2018 income years. If the disputant was considered not to have been in a de facto relationship, the Commissioner's position was that she would have had a reduced or nil entitlement to WfFTC.

Issues

The determinative issue for the TRA to consider was whether the disputant was in a de facto relationship that required her partner's income to be taken into account for the purposes of WfFTC.

If it was found that the disputant was not in a de facto relationship, two further issues for consideration were:

- The periods in which the stolen money is taken into account (the disputant's contention was that it should be attributed to 37 weeks of the relevant income years).
- Whether the disputant's gambling addiction should, on a discretionary basis, allow her to retain the WfFTC, if she was otherwise not entitled to it.

Decision

The TRA found that the disputant was in a de facto relationship which meant that Mr X's income had to be taken into account for the purposes of WfFTC.

The TRA acknowledged that the Commissioner had pointed to contemporaneous written records that showed the disputant was in a de facto relationship with Mr X, including that they were living at the same address, they were financially interdependent, and presented themselves as a couple.

The disputant and Mr X sought to explain their relationship in terms of ties in a social group and family, that they did not live together and have never had a relationship in the nature of marriage. In response to evidence of cohabitation, an explanation was given that Mr X used the disputant's basement as a workshop and Mr X lived at a different address with his children and grandchildren. They also said they did not share money.

The TRA was not convinced by the evidence given by the disputant, Mr X and the disputant's sister. The TRA considered that neither the disputant nor Mr X could explain why the Mr X created a systematic record that was inconsistent with him and the disputant being in a relationship, and to a lesser extent, the disputant doing that too. The TRA commented that he could not place reliance on the evidence given as it could not explain the evidence of their conduct at the time.

The TRA addressed the evidence given by the disputant's sister and considered that her evidence could go no way to explaining the discrepancies between the contemporaneous materials and the explanations from the disputant and her partner.

In relation to the disputant's argument that stolen funds should only be attributed to 37 weeks of the relevant income years, the TRA considered that the effect of s CB 32 of the Income Tax Act 2007 meant that whatever year property was obtained is the tax year to which it is allocated. There is no scope for an argument that it is allocated to particular weeks as the disputant contended.

In relation to the issue of whether the Commissioner or the TRA should excuse the disputant for her liability in whole or in part on a discretionary basis, the TRA acknowledged that the Commissioner has some discretion under sections 6 and 6A of the Tax Administration Act 1994 in relation to tax collection but said that it is not a general discretion to relieve taxpayers of the liabilities imposed by the Tax Acts. Further, the TRA considered that the disputant's circumstances to be far from justifying the exercise of such discretion stating that a taxpayer who has stolen money to gamble cannot expect to be relieved of tax consequences that would apply to another taxpayer in otherwise identical circumstances.

REGULAR CONTRIBUTORS TO THE TIB

Tax Counsel Office

The Tax Counsel Office (TCO) produces a number of statements and rulings, such as interpretation statements, binding public rulings and determinations, aimed at explaining how tax law affects taxpayers and their agents. The TCO also contributes to the "Questions we've been asked" and "Your opportunity to comment" sections where taxpayers and their agents can comment on proposed statements and rulings.

Legal Services

Legal Services manages all disputed tax litigation and associated challenges to Inland Revenue's investigative and assessment process including declaratory judgment and judicial review litigation. They contribute the legal decisions and case notes on recent tax decisions made by the Taxation Review Authority and the courts.

Technical Standards

Technical Standards sits within Legal Services and contributes the standard practice statements which describe how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical operational issues arising out of the administration of the Inland Revenue Acts. They also produce determinations on standard costs and amortisation or depreciation rates for fixed life property used to produce income, as well as other statements on operational practice related to topical tax matters. Technical Standards also contributes to the "Your opportunity to comment" section.

Policy and Regulatory Stewardship

Policy advises the Government on all aspects of tax policy and on social policy measures that interact with the tax system. They contribute information about new legislation and policy issues as well as Orders in Council.