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TAX INFORMATION Bulletin

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Inland Revenue
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YOUR OPPORTUNITY TO COMMENT

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

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Ref	Draft type	Title	Comment deadline
PUB00508	Question we've been asked	Income tax – portfolio investment entity income from land development activities	15 April 2026

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IN SUMMARY

NEW LEGISLATION

This section of the TIB covers new legislation, changes to legislation including general and remedial amendments, and Orders in Council. These commentaries are first published on the **Tax Policy website** shortly after any new legislation is enacted or Orders in Council are made to help affected taxpayers and their advisors understand the consequences of the changes.

SL 2026/15: Tax Administration (Reportable Jurisdictions for Application of CRS Standard) Amendment Regulations 2026

Order

The Tax Administration (Reportable Jurisdictions for Application of CRS Standard) Amendment Regulations 2026 were made on 16 February 2026 and come into force on 31 March 2026. The regulations update New Zealand's existing list of 111 reportable jurisdictions by adding Cameroon and Mongolia.

Background

Reportable jurisdictions are relevant to the Common Reporting Standard (CRS), which was enacted in New Zealand in 2017 as part of New Zealand's implementation of the G20/OECD Standard for Automatic Exchange of Financial Account Information in Tax Matters (AEOI). Reportable jurisdictions are territories to which Inland Revenue will provide certain information on their residents that is reported to Inland Revenue by financial institutions, in accordance with the CRS rules.

Pursuant to section 226D of the Tax Administration Act 1994, additions and deletions to the list of reportable jurisdictions must be made by Order in Council.

Effective date

Cameroon and Mongolia will be reportable jurisdictions for reporting periods beginning on or after 1 April 2025.

Further information

A full list of reportable jurisdictions can be found on the Inland Revenue website and the new Order in Council can be found at: **Tax Administration (Reportable Jurisdictions for Application of CRS Standard) Amendment Regulations 2026 (SL 2026/15) Contents – New Zealand Legislation**

LEGISLATION AND DETERMINATIONS

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

AE 26/01: Participating jurisdictions for the CRS applied standard

Issued: 25 February 2026

Effective: 1 April 2026

Determination

New Zealand's list of participating jurisdictions made by determination under section 91AAU of the Tax Administration Act 1994 for the purposes of the CRS applied standard and associated requirements under Part 11B of the Tax Administration Act 1994 has been amended with effect from the 1st of April 2026 as follows:

Jurisdictions added to the participating jurisdictions list

Cameroon	Mongolia	Trinidad and Tobago

Full list of participating jurisdictions from 1 April 2026

Albania	Andorra	Anguilla	Antigua and Barbuda
Argentina	Armenia	Aruba	Australia
Austria	Azerbaijan	Bahamas	Bahrain
Barbados	Belgium	Belize	Bermuda
Brazil	British Virgin Islands	Brunei	Bulgaria
Canada	Cameroon	Cayman Islands	Chile
China	Colombia	Cook Islands	Costa Rica
Croatia	Curaçao	Cyprus	Czech Republic
Denmark	Dominica	Ecuador	Estonia
Faroe Islands	Finland	France	Georgia
Germany	Ghana	Gibraltar	Greece
Greenland	Grenada	Guernsey	Hong Kong
Hungary	Iceland	India	Indonesia
Ireland	Isle of Man	Israel	Italy
Japan	Jamaica	Jersey	Jordan
Kazakhstan	Kenya	Korea	Kuwait

Latvia	Lebanon	Liechtenstein	Lithuania
Luxembourg	Macao	Malaysia	Maldives
Malta	Marshall Islands	Mauritius	Mexico
Moldova	Monaco	Mongolia	Montenegro
Montserrat	Morocco	Nauru	Netherlands
New Caledonia	New Zealand	Nigeria	Niue
Norway	Oman	Pakistan	Panama
Peru	Poland	Portugal	Qatar
Romania	Russia	Rwanda	Saint Kitts and Nevis
Saint Lucia	Saint Vincent and the Grenadines	Samoa	San Marino
Saudi Arabia	Senegal	Seychelles	Singapore
Sint Maarten	Slovak Republic	Slovenia	South Africa
Spain	Sweden	Switzerland	Thailand
Trinidad and Tobago	Tunisia	Türkiye	Turks and Caicos Islands
United Arab Emirates	United Kingdom	Uganda	Ukraine
Uruguay	Vanuatu		

Signed by John Nash on the 25th day of February 2026

John Nash
Strategic Advisor, International Revenue Strategy
Inland Revenue

References

Legislative references

Tax Administration Act 1994: s 91AAU

CFC 2026/01: Non-attributing active insurance CFC status TOWER Limited

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

A person has no attributed CFC income or loss from a CFC under sections CQ 2 and DN 2 of the Income Tax Act 2007 if the CFC is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007 because the requirements of sections CQ 2(1)(h) and DN 2(1)(h) are not satisfied.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC is a non-attributing active CFC if it is an insurer that meets the requirements of section 91AAQ of the Tax Administration Act 1994 and the Commissioner makes a determination under that section. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because an attributable CFC amount includes the CFC's income from an insurance business or from being an insurer under s EX 20B(3)(f) of the Income Tax Act 2007.

Section 91AAQ(1)(a) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of a CFC, if the CFC satisfies subsection (2). Pursuant to section 91AAQ(1)(a) and (7) of the Tax Administration Act 1994, Tower Limited has made an application to extend an earlier determination in respect of the CFC set out below. Tower Limited has a 30 September balance date.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the CFC satisfies the requirements set out in section 91AAQ(2) of the Tax Administration Act 1994 and is accordingly a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of the determination

The CFC to which this determination applies is:

Name	***Jurisdiction***
National Pacific Insurance (American Samoa) Limited	American Samoa

Interpretation

In this document, unless the context otherwise requires –

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a "controlled foreign company" as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994, I hereby determine that the above CFC is a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2026 and 2027 income years.

This determination is signed by me this 5th day of March 2026

Luke Schaumkell

Group Lead
Significant Enterprises

CFC 2026/02: Non-attributing active insurance CFC status TOWER Limited

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

A person has no attributed CFC income or loss from a CFC under sections CQ 2 and DN 2 of the Income Tax Act 2007 if the CFC is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007 because the requirements of sections CQ 2(1)(h) and DN 2(1)(h) are not satisfied.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC is a non-attributing active CFC if it is an insurer that meets the requirements of section 91AAQ of the Tax Administration Act 1994 and the Commissioner makes a determination under that section. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because an attributable CFC amount includes the CFC's income from an insurance business or from being an insurer under s EX 20B(3)(f) of the Income Tax Act 2007.

Section 91AAQ(1)(a) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of a CFC, if the CFC satisfies subsection (2). Pursuant to section 91AAQ(1)(a) and (7) of the Tax Administration Act 1994, Tower Limited has made an application to extend an earlier determination in respect of the CFC set out below. Tower Limited has a 30 September balance date.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the CFC satisfies the requirements set out in section 91AAQ(2) of the Tax Administration Act 1994 and is accordingly a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of the determination

The CFC to which this determination applies is:

Name	*Jurisdiction*
Tower Insurance (Cook Islands) Limited	Cook Islands

Interpretation

In this document, unless the context otherwise requires –

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a "controlled foreign company" as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994, I hereby determine that the above CFC is a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2026 and 2027 income years.

This determination is signed by me this 5th day of March 2026.

Luke Schaumkell

Group Lead
Significant Enterprises

CFC 2026/03: Non-attributing active insurance CFC status TOWER Limited

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

A person has no attributed CFC income or loss from a CFC under sections CQ 2 and DN 2 of the Income Tax Act 2007 if the CFC is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007 because the requirements of sections CQ 2(1)(h) and DN 2(1)(h) are not satisfied.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC is a non-attributing active CFC if it is an insurer that meets the requirements of section 91AAQ of the Tax Administration Act 1994 and the Commissioner makes a determination under that section. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because an attributable CFC amount includes the CFC's income from an insurance business or from being an insurer under s EX 20B(3)(f) of the Income Tax Act 2007.

Section 91AAQ(1)(a) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of members of a group of CFCs, if the members satisfy subsection (3). Pursuant to section 91AAQ(1)(a) and (7) of the Tax Administration Act 1994, Tower Limited has made an application to extend an earlier determination in respect of the CFC set out below. Tower Limited has a 30 September balance date.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the members of the group of CFCs satisfy the requirements set out in section 91AAQ(3) of the Tax Administration Act 1994 and are accordingly a non-attributing active CFCs for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of the determination

The CFCs to which this determination applies is:

Name	*Jurisdiction*
National Insurance Company (Holdings) Limited	Fiji
Tower Insurance (Fiji) Limited	Fiji
Southern Pacific Insurance Company (Fiji)) Limited	Fiji

Interpretation

In this document, unless the context otherwise requires –

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a "controlled foreign company" as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994, I hereby determine that the above CFCs are non-attributing active CFCs for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2026 and 2027 income years.

This determination is signed by me this 5th day of March 2026.

Luke Schaumkell

Group Lead
Significant Enterprises

CFC 2026/04: Non-attributing active insurance CFC status TOWER Limited

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

A person has no attributed CFC income or loss from a CFC under sections CQ 2 and DN 2 of the Income Tax Act 2007 if the CFC is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007 because the requirements of sections CQ 2(1)(h) and DN 2(1)(h) are not satisfied.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC is a non-attributing active CFC if it is an insurer that meets the requirements of section 91AAQ of the Tax Administration Act 1994 and the Commissioner makes a determination under that section. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because an attributable CFC amount includes the CFC's income from an insurance business or from being an insurer under s EX 20B(3)(f) of the Income Tax Act 2007.

Section 91AAQ(1)(a) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of a CFC, if the CFC satisfies subsection (2). Pursuant to section 91AAQ(1)(a) and (7) of the Tax Administration Act 1994, Tower Limited has made an application to extend an earlier determination in respect of the CFC set out below. Tower Limited has a 30 September balance date.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the CFC satisfies the requirements set out in section 91AAQ(2) of the Tax Administration Act 1994 and is accordingly a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of the determination

The CFC to which this determination applies is:

Name	***Jurisdiction***
National Pacific Insurance Limited	Samoa

Interpretation

In this document, unless the context otherwise requires –

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a "controlled foreign company" as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994, I hereby determine that the above CFC is a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2026 and 2027 income years.

This determination is signed by me this 5th Day of March 2026

Luke Schaumkell

Group Lead
Significant Enterprises

CFC 2026/05: Non-attributing active insurance CFC status TOWER Limited

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

A person has no attributed CFC income or loss from a CFC under sections CQ 2 and DN 2 of the Income Tax Act 2007 if the CFC is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007 because the requirements of sections CQ 2(1)(h) and DN 2(1)(h) are not satisfied.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC is a non-attributing active CFC if it is an insurer that meets the requirements of section 91AAQ of the Tax Administration Act 1994 and the Commissioner makes a determination under that section. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because an attributable CFC amount includes the CFC's income from an insurance business or from being an insurer under s EX 20B(3)(f) of the Income Tax Act 2007.

Section 91AAQ(1)(a) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of a CFC, if the CFC satisfies subsection (2). Pursuant to section 91AAQ(1)(a) and (7) of the Tax Administration Act 1994, Tower Limited has made an application to extend an earlier determination in respect of the CFC set out below. Tower Limited has a 30 September balance date.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the CFC satisfies the requirements set out in section 91AAQ(2) of the Tax Administration Act 1994 and is accordingly a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of the determination

The CFC to which this determination applies is:

Name	***Jurisdiction***
National Pacific Insurance (Tonga) Limited	Tonga

Interpretation

In this document, unless the context otherwise requires –

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a "controlled foreign company" as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994, I hereby determine that the above CFC is a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2026 and 2027 income years.

This determination is signed by me this 5th day of March 2026

Luke Schaumkell

Group Lead
Significant Enterprises

FDR 2026/01: No FDR method - Daintree High Income Trust – NZD class units

Issued | Tukuna: 4 March 2026

This determination provides that a New Zealand resident investor cannot use the fair dividend rate method to calculate FIF income from an investment in Daintree High Income Trust - NZD class units.

Discussion (which does not form part of the determination)

1. Investments in the NZD class units of the Daintree High Income Trust, an Australian Registered Managed Investment Scheme, are an attributing interest in a FIF for New Zealand resident investors when none of the exemptions in section EX 29 to EX 43 of the Income Tax Act 2007 apply.
2. The Fund is structured as an Australian Unit Trust and is a registered multi-class Managed Investment Scheme. Under section EX 32 of the Income Tax Act 2007 an exemption may arise for an Australian Unit Trust and a New Zealand resident investor so that a person's rights in the unit trust in an income year are not an attributing interest. The determination will only apply when an attributing interest arises.
3. New Zealand resident investors are required to apply the FIF rules to determine their tax liability in respect of their investment in shares in the Fund each year.
4. The Fund invests in a portfolio of global fixed interest securities and other financial arrangements. The Fund has on issue two types of unit class that provide holders of each class with an interest in the pool of investments held by the Fund. The NZD Unit Class of the Fund is a unit class denominated in New Zealand dollars. Foreign currency hedging arrangements are in place in relation to the NZD Unit Class of the Fund which effectively provide investors in this class with a New Zealand dollar denominated return on the financial arrangements held by the Fund.
5. The policy intention is that the FDR method of calculating FIF income should not be applied to investments that provide a New Zealand resident investor with a return similar to a New Zealand dollar denominated debt investment. It is appropriate for the Commissioner to take into account the whole of the arrangement in ascertaining whether an investment in a FIF provides the New Zealand-resident investor with a return akin to a New Zealand dollar denominated debt investment.
6. On this basis, where a New Zealand resident invests in the NZD Unit Class of the Fund, and holds an attributing interest in the FIF, I consider that it is appropriate for the investor holding that investment to be excluded from using the FDR method.

Scope of determination

7. This determination is issued on the basis of information provided to the Commissioner before the date of this determination and applies to an attributing interest in a FIF held by New Zealand resident investors in a non-resident issuer where:
    - The non-resident issuer:
        - is an Australian Registered Managed Investment Scheme;
        - is known at the date of this determination as the Daintree High Income Trust; and
        - is operated with separate classes of units.
    - The attributing interest consists of the New Zealand dollar denominated units issued in the Daintree High Income Fund, a class of units that provides an interest in the underlying assets of the fund that predominantly (i.e. 80% or more by value at a time in the income year) consist of financial arrangements such as international fixed interest securities; and
    - The investment interest attributable to the New Zealand dollar denominated class of units are subject to currency hedging arrangements undertaken by the non-resident issuer for the purpose of eliminating exchange rate risk for New Zealand investors on a highly effective basis.

Determination

8. Any investment by a New Zealand resident investor in the NZD class units of the Daintree High Income Trust ("the Fund"), to which none of the exemptions in section EX 29 to 43 of the Income Tax Act 2007 apply, is a type of attributing interest for which the investor may not use the fair dividend rate method to calculate foreign investment fund income from the interest.

Application Date

9. This determination applies for the 2026 and subsequent income years.

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

Interpretation

11. In this determination, unless the context otherwise requires-

- "Fair dividend rate method" means the fair dividend rate method under section YA 1 of the Income Tax Act 2007;
- "Financial arrangement" means financial arrangement under section EW 3 of the Income Tax Act 2007;
- "Foreign investment fund" means foreign investment fund under section YA 1 of the Income Tax Act 2007; and
- "New Zealand resident" means a person that is resident in New Zealand for the purposes of the Income Tax Act 2007.
- "Non-resident" means a person that is not resident in New Zealand for the purposes of the Income Tax Act 2007.

This determination was signed by me on 04 March 2026.

Warwick Smith

Technical Specialist
Inland Revenue

ITR37: 2026 International tax disclosure exemption

Issued: 31 March 2026

This determination sets out which interests in foreign companies and foreign investment funds for the year ended 31 March 2026 the Commissioner of Inland Revenue does not require a person to disclose for the administration of the international tax rules.

Introduction

1. Section 61 of the Tax Administration Act 1994 ("TAA") requires taxpayers to disclose interests in foreign entities.
2. Section 61(1) of the TAA states that a person who has a control or income interest in a foreign company or an attributing interest in a foreign investment fund ("FIF") at any time during the income year must disclose the interest held. In the case of partnerships, disclosure needs to be made by the individual partners in the partnership. The partnership itself is not required to disclose.
3. Section 61(2) of the TAA allows the Commissioner of Inland Revenue to exempt any person or class of persons from this requirement if disclosure is not necessary for the administration of the international tax rules (as defined in section YA 1) contained in the Income Tax Act 2007 ("ITA").
4. To balance the revenue forecasting and risk assessment needs of the Commissioner with the compliance costs of taxpayers providing the information, the Commissioner has issued an international tax disclosure exemption under section 61(2) of the TAA that applies for the income year corresponding to the tax year ended 31 March 2026. This exemption may be cited as "International Tax Disclosure Exemption ITR37 "("the 2026 disclosure exemption") and the full text appears at the end of this item.

Scope of exemption

5. The scope of the 2026 disclosure exemption is the same as the 2025 disclosure exemption.

Application date

6. This exemption applies for the income year corresponding to the tax year ended 31 March 2026.

Summary

7. In summary, the 2026 disclosure exemption **removes** the requirement of a resident to disclose:
    - An interest in a foreign company if the resident has an income interest of less than 10% in that company and either that income interest is not an attributing interest in a FIF or it falls within the $50,000 de minimis exemption (see section CQ 5(1)(d) and section DN 6(1)(d) of the ITA). The de minimis exemption does not apply to a person that has opted out of the de minimis threshold by including in the income tax return for the income year an amount of FIF income or loss.
    - If the resident is not a widely-held entity, an attributing interest in a FIF that is a direct income interest of less than 10%, if the foreign entity is incorporated (in the case of a company) or otherwise tax resident in a treaty country or territory, and the fair dividend rate or comparative value method of calculation is used.
    - If the resident is a widely-held entity, an attributing interest in a FIF that is a direct income interest of less than 10% (or a direct income interest in a foreign PIE equivalent) if the fair dividend rate or comparative value method is used for the interest. The resident is instead required to disclose the end-of-year New Zealand dollar market value of all such investments split by the jurisdiction in which the attributing interest in a FIF is held or listed.
8. The 2026 disclosure exemption also removes the requirement for a non-resident or transitional resident to disclose interests held in foreign companies and FIFs.

Commentary

9. Generally, residents who hold an income interest or a control interest in a foreign company, or an attributing interest in a FIF are required to disclose these interests to the Commissioner. These interests are considered in further detail below.

Attributing interest in a FIF

10. A resident is required to disclose an attributing interest in a FIF if FIF income or a FIF loss is calculated using one of the following calculation methods:

    - attributable FIF income, deemed rate of return, cost or revenue account methods; or
    - fair dividend rate or comparative value methods, if the resident is a "widely-held entity"; or
    - fair dividend rate or comparative value methods, if the resident is not a “widely-held entity” and either the foreign entity is incorporated or otherwise tax resident in a country or territory with which New Zealand does not have a double tax agreement in force as at 31 March 2024
    - or the resident has a direct income interest of 10% or more.

11. For the purpose of this disclosure exemption, the term "double tax agreement" does not include tax information exchange agreements or collection agreements and is limited to the double tax agreements in force as at 31 March 2026 with the 41 countries or territories listed below.

Australia	Indonesia	Singapore
Austria	Ireland	Slovak Republic
Belgium	Italy	South Africa
Canada	Japan	Spain
Chile	Korea	Sweden
China	Malaysia	Switzerland
Czech Republic	Mexico	Taiwan
Denmark	Netherlands	Thailand
Fiji	Norway	Turkey
Finland	Papua New Guinea	United Arab Emirates
France	Philippines	United Kingdom
Germany	Poland	United States of America
Hong Kong	Russian Federation	Viet Nam
India	Samoa	

12. For the purpose of this disclosure exemption, a "widely-held entity" is an entity which is a:

    - portfolio investment entity (this includes a portfolio investment-linked life fund); or
    - widely-held company; or
    - widely-held superannuation fund; or
    - widely-held group investment fund ("GIF").

13. Portfolio investment entity, widely-held company, widely-held superannuation fund and widely-held GIF are all defined in section YA 1 of the ITA.

14. The disclosure required, by widely-held resident entities, of attributing interests in FIFs in which the resident has a direct income interest of less than 10% (or a direct income interest in a foreign PIE equivalent) and for which they use the fair dividend rate or the comparative value method of calculation is that, for each calculation method, they disclose the end-of-year New Zealand dollar market value of investments split by the jurisdiction in which the attributing interest in a FIF is held, listed, organised or managed.

15. In the event that the jurisdiction is not easily determined, a further option of a split by currency in which the investment is held will also be accepted as long as it is a reasonable proxy - that is at least 90-95% accurate - for the underlying jurisdiction in which the FIF is held, listed, organised or managed. Investments denominated in euros will not be able to meet this test and so euro denominated investments will need to be split into the underlying jurisdictions.

FIF interests

16. The types of interests that fall within the scope of section 61(1) of the TAA are:

- rights in a foreign company (a company includes any entity deemed to be a company for the purposes of the ITA (e.g. a unit trust))
- rights in a foreign superannuation scheme held by a person as a beneficiary or member, if the person acquired the interest before 1 April 2014 and treated the interest as a FIF interest in a return of income filed before 20 May 2013 and for all subsequent income years
- rights in a foreign superannuation scheme held by a person as a beneficiary or member, if the person's interest in the scheme was first acquired whilst the person was tax resident of New Zealand
- rights to benefit from a life insurance policy offered and entered into outside New Zealand
- rights in an entity specified in schedule 25, part A of the ITA.

17. However, interests that are exempt (under sections EX 31 to EX 43B of the ITA) from being an attributing interest in a FIF do not have to be disclosed. The following is a summary of these exemptions:

- certain interests in Australian resident companies included on the official list of the Australian Stock Exchange and required to maintain a franking account (refer to Inland Revenue's website ird.govt.nz (keyword: other exemptions))
- certain interests in Australian unit trusts that have a New Zealand RWT proxy and either a high turnover or high distributions
- interests held by a natural person in foreign superannuation schemes that are an Australian approved deposit fund, Australian exempt public sector superannuation scheme, Australian regulated superannuation fund or Australian retirement savings account
- income interests of 10% or more in controlled foreign companies ("CFCs") (although separate disclosure is required of these as interests in foreign companies – refer below)
- certain interests of 10% or more in foreign companies that are treated as resident, and subject to tax, in Australia (although separate disclosure is required of these as interests in foreign companies – refer below)
- interests in certain unlisted grey-list companies which have migrated out of New Zealand for a year which begins within 10 years of that migration, where the person has held the interests continuously since the migration and the company has retained a significant presence in New Zealand through a fixed establishment
- interests in certain unlisted grey-list companies which hold more than 50% of a New Zealand company for a year which begins within 10 years of the company first holding that 50%, where the New Zealand company has retained a significant presence in New Zealand
- certain interests in grey-list companies resulting from shares acquired under a venture investment agreement
- interests in certain grey-list companies resulting from the acquisition of shares under certain employee share schemes
- certain interests held by natural persons in FIFs located in a country where exchange controls prevent the person deriving amounts from the interests, or from disposing of the interests, in New Zealand currency or consideration readily convertible to New Zealand currency
- certain interests in foreign superannuation schemes or life insurance policies (offered and entered into outside New Zealand) held by natural persons who acquired the interests when a non-resident or transitional resident
- beneficial interests in foreign superannuation schemes which are not FIF superannuation interests

- certain interests in pensions or annuities provided by FIFs and held by natural persons who acquired the interests when a non-resident (or in certain cases, a resident) (see Inland Revenue's guide Overseas pensions and annuity schemes (IR257) for more information)
- certain interests of share users in original shares and identical shares in returning share transfers

De minimis

18. Interests of less than 10% in foreign companies which are attributing interests in a FIF held by a natural person not acting as a trustee also do not have to be disclosed if the total cost of the interests is $50,000 or less at all times during the income year. This disclosure exemption is made because no FIF income under section CQ 5 of the ITA or FIF loss under section DN 6 of the ITA arises in respect of these interests.

19. This de minimis exemption does not apply to a person who has included in the income tax return for the year a FIF income or loss. Please note that a person opting out of the de minimis threshold is generally required to continue to apply the FIF rules in each subsequent tax year. Where a person has included FIF income or loss from attributing interests in FIFs where the total cost was $50,000 or less in 1 of the preceding 4 income years, they will be required to apply the FIF rules in the current year.

Format of disclosure - FIF

20. The forms for the disclosure of FIF interests are as follows:

    - IR443 form for the deemed rate of return method
    - IR447 form for the fair dividend rate method (for individuals or non-widely-held entities)
    - IR448 form for the comparative value method (for individuals or non-widely-held entities)
    - IR449 form for the cost method
    - IR458 spreadsheet form (this spreadsheet form can be used to make electronic disclosures for all methods)
    - myIR income tax return attachment form (this form can be used to make electronic disclosures for all methods)

21. The IR458 spreadsheet and myIR income tax return attachment forms, which are the only disclosure options for the fair dividend rate and comparative value methods for widely-held entities, and the revenue account method must be filed online. Disclosure of FIF interests by widely-held entities using the fair dividend rate or comparative value methods may be made by country rather than by individual investment where the direct income interests are less than 10% (or are direct income interests in a foreign PIE equivalent).

22. If you choose the spreadsheet option you will be able to save the form as a working paper on your computer. When completed, submit the form by logging into your myIR account and uploading it as part of the electronic income tax return filing process, or by logging into your myIR account and attaching it to a web message with 'FIF disclosure' in the subject line.

23. Alternatively, you can complete the myIR income tax return attachment disclosure form online when preparing your income tax return electronically in myIR.

24. The IR443, IR447, IR448, IR449 and IR458 forms can be found at **ird.govt.nz/income-tax/income-tax-for-businesses-and-organisations/types-of-business-income/foreign-investment-funds-fifs/file-a-foreign-investment-fund-disclosure**. Click 'Other ways to do this' on this web page to access the IR458 spreadsheet form.

Revenue account method - election and disclosure

25. From 1 April 2025 taxpayers will be able to elect to use the revenue account method. To elect into this method, taxpayers must complete the myIR income tax return attachment in the first income year they are eligible to use the revenue account method. The myIR income tax return attachment must also be completed every subsequent year that they are using the revenue account method.

Income interest of 10% or more in a foreign company

26. A resident is required to disclose an income interest of 10% or more in a foreign company. This obligation to disclose applies to all foreign companies regardless of the country of residence. For this purpose, the following income interests need to be considered:

    - an income interest held directly in a foreign company
    - an income interest held indirectly through any interposed foreign company
    - an income interest held by an associated person (not being a CFC) as defined by subpart YB of the ITA.

27. To determine whether a resident has an income interest of 10% or more for CFCs, sections EX 14 to EX 17 of the ITA should be applied. To determine whether a resident has an income interest of 10% or more in any entity that is not a CFC, for the purposes of this exemption, sections EX 14 to EX 17 should be applied to the foreign company as if it were a CFC.

Format of disclosure - CFC

28. The forms for disclosure of all interests in a CFC are:

    - IR458 spreadsheet form, or
    - myIR income tax return attachment form

29. If you choose the spreadsheet option you will be able to save the form as a working paper on your computer. When completed, submit the form by logging into your myIR account and uploading it as part of the electronic income tax return filing process.

30. Alternatively, you can complete the myIR income tax return attachment disclosure form online when preparing your income tax return electronically in myIR.

31. The IR458 spreadsheet form must be accessed online at **www.ird.govt.nz** (keyword: IR458).

32. Please note that electronic filing is a mandatory requirement for CFC disclosure

Overlap of interests

33. It is possible that a resident may be required to disclose an interest in a foreign company which also constitutes an attributing interest in a FIF. For example, a person with an income interest of 10% or greater in a foreign company that is not a CFC is strictly required to disclose both an interest held in a foreign company and an attributing interest in a FIF.

34. To meet disclosure requirements, only one form of disclosure is required for each interest. If the interest is an attributing interest in a FIF, then the appropriate disclosure for the calculation method, as discussed previously, must be made.

35. In all other cases, where the interest in a foreign company is not an attributing interest in a FIF, the IR458 spreadsheet form or myIR income tax return attachment form for CFCs must be filed.

Interests held by non-residents and transitional residents

36. Interests held by non-residents and transitional residents in foreign companies and FIFs do not need to be disclosed.

37. This would apply for example to an overseas company operating in New Zealand (through a branch) in respect of its interests in foreign companies and FIFs; or to a transitional resident with interests in a foreign company or an attributing interest in a FIF.

38. Under the international tax rules, non-residents and transitional residents are not required to calculate or attribute income under either the CFC or FIF rules. Therefore, disclosure of non-residents' or transitional residents' holdings in foreign companies or FIFs is not necessary for the administration of the international tax rules and so an exemption is made for this group.

Determination - Disclosure exemption

Persons not required to comply with section 61 of the Tax Administration Act 1994

This exemption may be cited as "International Tax Disclosure Exemption ITR36".

Reference

1. This exemption is made under section 61(2) of the Tax Administration Act 1994 ("TAA"). It details interests in foreign companies and attributing interests in foreign investment funds ("FIFs") in relation to which any person is not required to comply with the requirements in section 61 of the TAA to make disclosure of their interests, for the income year ended 31 March 2026.

Interpretation

2. For the purpose of this disclosure exemption:
   - to determine an income interest of 10% or more in a foreign company, sections EX 14 to EX 17 of the Income Tax Act 2007 ("ITA") apply for interests in controlled foreign companies ("CFCs"). In the case of attributing interests in FIFs, those sections are to be applied as if the FIF were a CFC, and
   - "double tax agreement" means a double tax agreement in force as at 31 March 2026 in one of the 41 countries or territories as set out in the commentary.
3. The relevant definition of "associated persons" is contained in subpart YB of the ITA.
4. Otherwise, unless the context requires, expressions used have the same meaning as in section YA 1 of the ITA.

Exemption

5. Any person who holds an income interest of less than 10% in a foreign company, including interests held by associated persons, that is not an attributing interest in a FIF, or that is an attributing interest in a FIF in respect of which no FIF income or loss arises due to the application of the de minimis exemption in section CQ 5(1)(d) or section DN 6(1)(d) of the ITA , is not required to comply with section 61(1) of the TAA for that person's interests in the foreign company and that income year.
6. Any person who is a portfolio investment entity, widely-held company, widely-held superannuation fund or widely-held GIF, who has an attributing interest in a FIF, other than a direct income interest of 10% or more in a foreign company that is not a foreign PIE equivalent, and uses the fair dividend rate or comparative value calculation method for that interest, is not required to comply with section 61(1) of the TAA in respect of that interest and that income year, if the person discloses the end-of-year New Zealand dollar market value of investments, in an electronic format prescribed by the Commissioner, split by the jurisdiction in which the attributing interest in a FIF is held, organised, managed or listed.
7. Any person who is not a portfolio investment entity, widely-held company, widely-held superannuation fund or widely-held GIF, who has an attributing interest in a FIF, other than a direct income interest of 10% or more in a foreign company, and uses the fair dividend rate or comparative value calculation method is not required to comply with section 61(1) of the TAA in respect of that interest and that income year, to the extent that the FIF is incorporated or tax resident in a country or territory with which New Zealand has a double tax agreement in force at 31 March 2026.
8. Any non-resident person or transitional resident who has an income interest or a control interest in a foreign company or an attributing interest in a FIF in the income year corresponding to the tax year ending 31 March 2026, is not required to comply with section 61(1) of the TAA in respect of that interest and that income year if either or both of the following apply:
   - no attributed CFC income or loss arises in respect of that interest in that foreign company under sections CQ 2(1)(d) or DN 2(1)(d) of the ITA; and/or
   - no FIF income or loss arises in respect of that interest in that FIF under sections CQ 5(1)(f) or DN 6(1)(f) of the ITA.

This exemption is made by me acting under delegated authority from the Commissioner of Inland Revenue pursuant to section 7 of the TAA.

This exemption is signed on 31 March 2026.

Glen Holbrook
Technical Specialist

INTERPRETATION STATEMENT

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

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

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

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 26/01: Income tax – deductibility of repairs and maintenance expenditure – general principles

Issued | Tukuna: 2 March 2026

This interpretation statement considers the general principles governing the income tax treatment of expenditure taxpayers incur in carrying out work on tangible property they use in a business or income-earning activity.

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

REPLACES | WHAKAKAPIA

- **IS 12/03**: Income tax – deductibility of repairs and maintenance expenditure – general principles *Tax Information Bulletin* Vol 24, No 7 (August 2012): 68

Summary | Whakarāpopoto

1. This interpretation statement considers the general principles governing the income tax treatment of expenditure taxpayers incur in carrying out work on tangible property they use in a business or income-earning activity.[1] The nature of this work may be described using various terms, including repairs, maintenance, alterations or improvements. Also, the terms repairs, maintenance or repairs and maintenance are sometimes used to denote expenditure that is revenue in nature and deductible. In this statement, the expenditure incurred for such work is called "repairs and maintenance expenditure". And, unless otherwise shown, this term is used as a general, tax-neutral term (ie, it does not imply, confirm or deny the expenditure's deductibility).
2. A deduction for repairs and maintenance expenditure is allowed if it meets the requirements of the general permission in s DA 1(1) and is not excluded by any of the general limitations in s DA 2. This statement focuses on the capital limitation in s DA 2(1). Other general limitations, such as the private limitation, are not covered. The statement also does not consider any specific deduction provisions in part D that override the capital limitation for certain types of expenditure.
3. To qualify for a deduction under the general permission, the taxpayer must incur the repairs and maintenance expenditure in deriving their assessable income, excluded income or both. Alternatively, the taxpayer must incur the expenditure in the course of carrying on a business for the purpose of deriving assessable income, excluded income or both.
4. The capital limitation in s DA 2(1) denies a deduction for repairs and maintenance expenditure that satisfies the general permission but is capital in nature. Capital expenditure is not deductible but may be depreciated under the rules in subpart EE. If those rules are satisfied, a depreciation loss is available, based on the amount of the capital expenditure.[2] This statement does not cover the depreciation rules.

1 Additional specific guidance exists regarding repairs and maintenance in the context of dairy farming (IS0025), residential rental properties and healthy homes (QB 20/01). See the References section of this statement at page 71.

2 Note that since the 2024–25 income year, most buildings and any capital improvements have a 0% depreciation rate.

5. The approach to decide whether an outgoing is of a capital or revenue nature is well established by the courts and involves considering the full set of circumstances, including what the expenditure is calculated to effect from a practical business point of view. Several commonly cited factors to consider include:

    - the need or occasion that calls for the expenditure;
    - whether the expenditure is recurrent;
    - whether the expenditure is a once and for all payment, producing assets or advantages that are of an enduring benefit;
    - whether the expenditure is on the business structure or business process;
    - whether the expenditure creates an identifiable asset;
    - whether the source of the payment is from fixed or circulating capital; and
    - how the expenditure is treated according to ordinary principles of commercial accounting.

6. When these factors are applied in the context of repairs and maintenance expenditure, the courts use a two-step approach to decide whether the expenditure is capital or revenue in nature:

    - Identify the relevant asset that is being repaired or worked on.
    - Consider the nature and extent of the work done to that asset.

7. However, the courts emphasise that each situation is unique, and the specific facts must be carefully considered when applying case authorities to different circumstances.

Step 1 – identify the relevant asset

8. To decide whether the capital limitation applies to repairs and maintenance expenditure, first identify the asset being worked on as the object or subject matter of the expenditure incurred. This is necessary so an assessment can be made at the second step to determine whether the nature and extent of work undertaken on the asset means the expenditure is of a capital or revenue nature.

9. Identifying the relevant asset is always a question of fact, degree and impression. It involves applying what is referred to as an "entirety test" to determine the relevant totality or entirety of a physical thing that satisfies a particular notion.

10. A danger of distortion exists, however, if too large or too small a subject matter is identified. This can lead to incorrectly characterising repairs and maintenance expenditure when evaluating the nature and extent of the work undertaken on the asset identified.

11. The courts have considered various relevant factors when applying this test. Firstly, factors that might suggest the item under consideration **is** the relevant asset are where the item:

    - is physically distinct from a wider asset of which the item might be a part;
    - is functionally complete (to some degree); or
    - varies the function of another item.

12. Secondly, factors that might suggest the item under consideration **is not** the relevant asset are where the item:

    - has a physical connection with other items;
    - is part of an integrated system; or
    - is a necessary part to complete something else.

13. The principles for identifying assets for repairs and maintenance purposes are the same as those for identifying an item of property for depreciation. This means, as a rule, the tangible asset considered for repairs and maintenance purposes is the same as the item of property for depreciation. In special cases, where the taxpayer does not wholly own the object of the work, the asset for repairs and maintenance and the asset for depreciation may not entirely match. For repairs and maintenance, the asset is the object of the work while the item of depreciable property may be the part that the taxpayer owns (eg, an apartment in an apartment complex).[3]

3 In some instances, the Act deems the identity of the asset for depreciation and repairs and maintenance purposes. See, for example, commercial fit outs and s DB 22B or distribution networks and s DB 68. For more information on what is a commercial fit-out, see IS 22/04: Claiming depreciation on buildings Tax Information Bulletin Vol 34, No 8 (September 2022): 9.

Step 2 – consider the nature and extent of the work done

14. Once the relevant asset is identified, the second step in deciding whether the capital limitation applies to repairs and maintenance expenditure is to consider the nature and extent of the work done to that asset.

15. Two key questions arise when considering the nature and extent of the work done on an asset, the answers to which are a matter of fact and degree:

    - Has the work led to the asset's reconstruction, replacement or renewal, either entirely or substantially? If yes, the repairs and maintenance expenditure is considered capital expenditure.
    - If the work does not involve an entire or substantial reconstruction, replacement or renewal, has it gone beyond repairs and changed the asset's character. If yes, the repairs and maintenance expenditure is also considered capital in nature.

16. When deciding whether the work done is capital in nature, consider the nature, extent and scale of the work done to the asset. Deciding the scale of the work done includes considering the significance of the work done to the asset. Changes to an asset's value, earning capacity, useful life, function or operating capacity—whether intended or not—are relevant but cannot alone decide the nature of the work done to the asset. The cost of the work may also be relevant.

17. The character of the repairs and maintenance expenditure depends on the nature and extent of the work actually done to the asset. There is no deduction for notional or hypothetical amounts that might have been spent on repairs, had the work been done differently.

18. Delaying repairs or taking a long time to complete them does not by itself change the character of repairs and maintenance expenditure from being deductible revenue expenditure to non-deductible capital expenditure.

19. Repairs and maintenance expenditure that is part of an overall capital project is considered part of that project and capital in nature. If the work is done on an ad hoc basis and not as part of one overall plan, the capital or revenue character of the expenditure depends on the nature and effect of that work on the asset. It is appropriate and possible, therefore, in some situations to apportion expenditure between deductible repair costs and non-deductible capital works.

20. No deduction is allowed for the costs of work essential to bringing a recently acquired asset up to a condition suitable for the taxpayer's long-term use. Such expenditure forms part of the capital cost of acquiring the asset.[4]

21. The character of repairs and maintenance expenditure remains the same whether the repairs are due to a significant event such as a fire, flood or earthquake or whether they are due to other reasons.

22. If an asset is damaged because of an inherent defect, the cause of the work and the removal of the defect are relevant, but not solely determinative. For leaky buildings, fixing weathertightness issues usually requires removing the defect, which often involves major parts of the building and substantial work. Unless limited in its nature and extent, this work is likely to go beyond a repair and change the character of the building from its original, defective, condition. If so, the expenditure is capital in nature and therefore not deductible.

Introduction | Whakataki

Approach to deductibility of repairs and maintenance expenditure

23. This statement sets out the Commissioner's views on the general principles governing the deductibility of repairs and maintenance expenditure. Typically, this type of expenditure arises when some work is done to an item of tangible property that may be depreciable property. As mentioned at [1], the term "repairs and maintenance expenditure" is used in this statement as a general tax-neutral term.

24. The analysis is based on the general provisions in the Act, the well-established distinction courts have made between capital and revenue, and those decisions where the courts have specifically considered repairs and maintenance expenditure. It explains the general principles. Some specific tax rules not covered by this statement might apply in some situations (eg, expenditure on aircraft engine overhauls that are required under Civil Aviation rules[5]).

4 See QB 25/17: Income tax: Can I claim a deduction for expenses I incur on repairing a recently acquired capital asset? *Tax Information Bulletin* Vol 37, No 7 (August 2025): 61.

5 See s DW 5.

25. The approach in this statement is that, before repairs and maintenance expenditure can be deducted, it must be deductible under the general permission (s DA 1). Then, the statement explains how to decide whether a deduction allowed under the general permission is denied due to the capital limitation (s DA 2(1)). This requires identifying the asset involved and applying principles derived from the case law to decide whether the cost of the work done to that asset is capital or revenue in nature.

26. If the expenditure is capital in nature, a deduction for that expenditure is denied (assuming no other specific provisions allow a deduction). If the expenditure is revenue in nature, a deduction for the expenditure is allowed, subject to any other legislative requirements being satisfied.

27. When distinguishing between capital and revenue, the decision depends on the specific facts and circumstances involved. It is crucial to carefully apply the principles derived from case law and to take care when applying case authorities to different situations.

28. The approach in this statement is primarily concerned with applying the capital limitation in s DA 2(1). Other limitations to the general permission might deny a deduction for repairs and maintenance expenditure, in whole or in part (eg, the private limitation in s DA 2(2)). These other limitations are not considered in this statement.

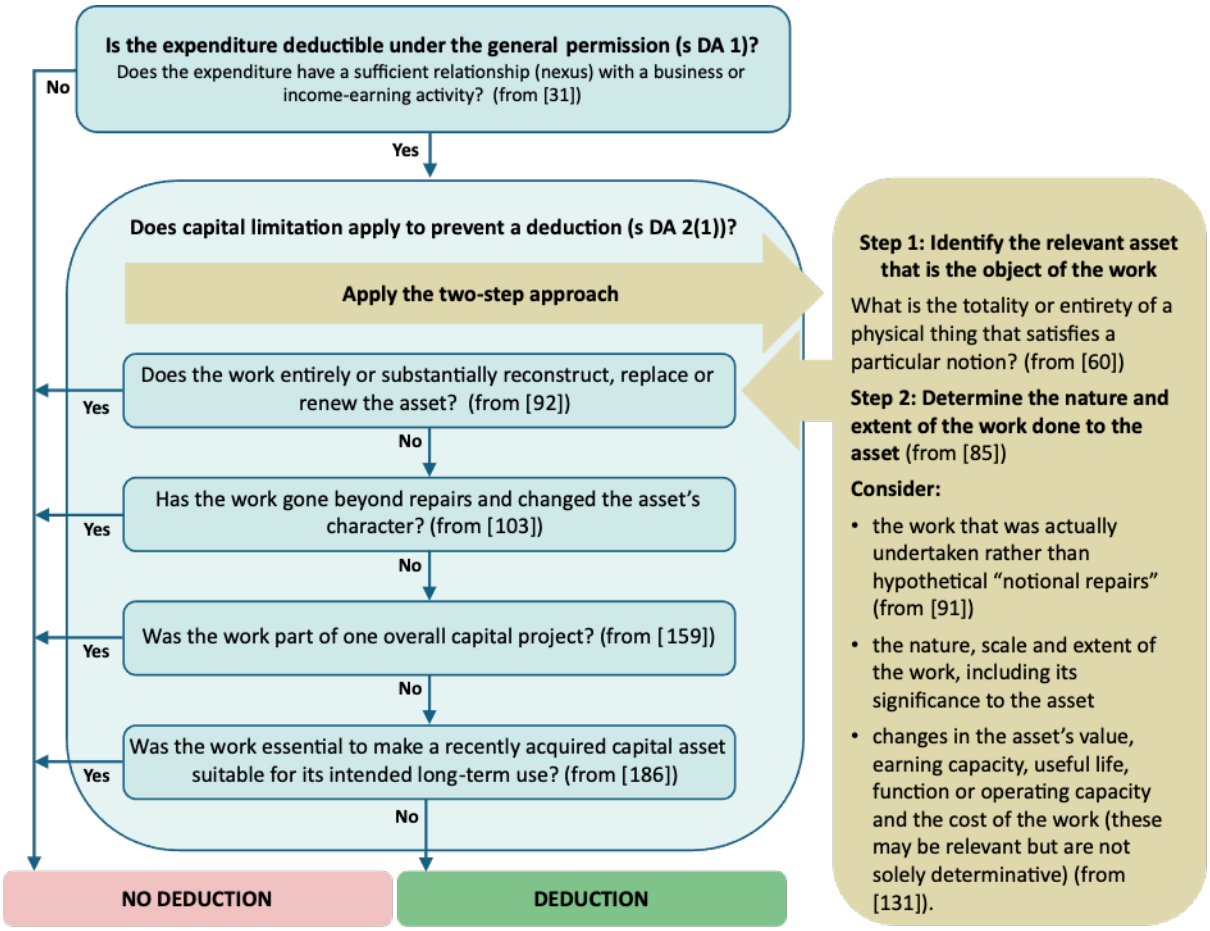
29. Capital expenditure is not deductible but can be considered under the depreciation rules in subpart EE or the Investment Boost rules in subpart DI. If those rules are satisfied, a deduction for a depreciation loss or Investment Boost may be available. Special rules, however, apply for buildings.[6] The availability or otherwise of a depreciation loss or an Investment Boost deduction is outside the scope of this statement.

Flowchart – approach to analysis

30. The flowchart in Figure | Hoahoa 1 shows the analytical approach to determining the income tax treatment of repairs and maintenance expenditure (cross-references to the relevant portions of the statement appear in brackets).

6 Depreciation was allowed for most buildings until 2011. For the 2012 to 2020 income years, the depreciation rate for buildings with an estimated life of more than 50 years was set at 0%. For the 2021 to 2024 income years, non-residential buildings could be depreciated again. From the 2024–25 income year, the depreciation rate for these buildings returned to 0%. From 22 May 2025 a 20% Investment Boost deduction may be available for capital repairs and maintenance expenditure that is an improvement to an item of depreciable property, such as a commercial building.

Figure | Hoahoa 1: Summary of analytical approach



Is the expenditure deductible under the general permission?

31. To decide whether repairs and maintenance expenditure is deductible, the first consideration is whether the expenditure meets the general permission in s DA 1.

32. Section DA 1 provides:

> **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.

Connection or nexus with income

33. Section DA 1(1)(a) provides for the deductibility of expenditure that is incurred in deriving assessable income (or excluded income, or a combination of these). Section DA 1(1)(b) provides for the deductibility of expenditure incurred in the course of carrying on a business for the purpose of deriving assessable income (or excluded income, or a combination of these).

34. Section DA 1(1) requires a connection between the taxpayer's expenditure and either deriving assessable income or carrying on a business for the purpose of deriving assessable income. This connection is known as the statutory nexus.

35. The leading cases on the statutory nexus are the Court of Appeal decisions in *Banks*, *Buckley & Young* and *NRS Media Holdings*.[7] The decisions emphasise the need for a sufficient nexus between the expenditure and the assessable income or business activities for the expenditure to be deductible.

36. To decide whether a sufficient nexus or connection exists, it is necessary to consider the true character of the expenditure and how it relates to the taxpayer's income-earning activities. This should be based on the facts at the time the expenditure is incurred. The expenditure must be connected to an ongoing income-earning process. The ongoing nature of the process is determined as a matter of fact and degree.

37. 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.[8] What differs is what the relevant expenditure must have a sufficient connection with. Paragraph (b) of s DA 1, which applies only to business taxpayers, allows a wider approach than para (a). Unlike under para (a), expenditure under para (b) may still be deductible even where that expenditure cannot be linked directly to earning income in some positive way.

38. Under the general permission, a deduction is allowed for expenditure "to the extent to which" it meets the provision's requirements. This means it is possible to apportion expenditure if it can be divided into deductible and non-deductible portions.[9]

Key point on the general permission

39. The key point about the general permission is that no deduction is available unless the repairs and maintenance expenditure has a sufficient relationship, connection or nexus with carrying on a business or an income-earning activity.

Examples 1–2: nexus with income

40. The nexus between expenditure and income is illustrated in Example | Tauira 1 and Example | Tauira 2.

Example | Tauira 1 – Nexus with income – temporary break in rental activity

Jack owns a rental property, and his tenant has just moved out. Despite advertising, Jack cannot find a new tenant. He concludes that the property is too run down to attract potential tenants so he decides to tidy up the property to make it more attractive. The property is temporarily unavailable for rental while Jack arranges to have the property repaired, cleaned and painted. Once this work is completed Jack will look for a new tenant.

The repairs and maintenance expenditure Jack incurs has a sufficient nexus to his deriving assessable income from his rental activity.

Example | Tauira 2 – Nexus with income – repairs after rental activity ended

Tina owned a residential rental property for several years but moved into it two years ago, making it her home. This year she repaired and repainted the property, and she wants to claim a deduction for the cost of the repairs on the basis they relate to damage that occurred when it was rented out.

The repairs and maintenance expenditure is not deductible because the rental activity has ended, and the house is no longer used to derive assessable income. At the time the expenditure was incurred, it did not have the necessary nexus with Tina's assessable income.

7 *CIR v Banks* (1978) 3 NZTC 61,236 (CA); *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271 (CA) and *NRS Media Holdings Ltd v CIR* [2018] NZCA 472.

8 See *NRS Media Holdings* at [30].

9 See *Banks* at 61,241 and *Buckley & Young* at 61,274.

Does the capital limitation deny deduction?

General principles for distinguishing capital or revenue

41. Once it is decided a deduction is available for repairs and maintenance expenditure under the general permission, the next step is to decide whether the deduction is denied by the capital limitation in s DA 2(1). The capital limitation denies a deduction where an amount of expenditure is found to be capital in nature.

42. The New Zealand courts have a well-established approach to distinguishing between capital or revenue. The Court of Appeal summarised it in *Trustpower*:[10]

> **General principles**
>
> [51] The correct approach to the distinction between income and capital is well-established by appellate authority in New Zealand, Australia and England. … [W]e are able to summarise it relatively briefly. …
>
> [52] The starting point is invariably the classic 1946 judgment of Dixon J in *Hallstroms Pty Ltd v Federal Commissioner of Taxation* where he made two statements of general principle that have been followed ever since. The first statement is:
>
> > … the contrast between the two forms of expenditure corresponds to the distinction between the acquisition of the means of production and the use of them; between establishing or extending a business organization and carrying on the business; between the implements employed in work and the regular performance of the work in which they are employed; between an enterprise itself and the sustained effort of those engaged in it.
>
> [53] The second statement, … is:
>
> > What is an outgoing of capital and what is an outgoing on account of revenue depends on what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process.

43. The Court of Appeal considered *Hallstroms* was followed and adapted in other leading cases, particularly in *Nchanga Consolidated Copper Mines*, where Viscount Radcliffe stated:[11]

> Again courts have stressed the importance of observing a demarcation between the cost of creating, acquiring or enlarging the permanent (which does not mean perpetual) structure of which the income is to be the produce or fruit and the cost of earning that income itself or performing the income earning operations. Probably this is as illuminating a line of distinction as the law by itself is likely to achieve …

44. The Court of Appeal in *Trustpower* then stated these general principles were adopted in *BP Australia*[12] where the Privy Council also relied on specific factors (or indicia) identified by Dixon J in *Sun Newspapers Ltd*[13] (known as the *BP Australia* factors, discussed next).[14] However the Court of Appeal noted that the *BP Australia* factors may not always be needed:

> [76] We pause at this point to emphasise:
>
> (a) **The general principles stated by Dixon J in *Hallstroms* and Viscount Radcliffe in *Nchanga* remain the best guide for distinguishing between income and capital and may well be sufficient for that purpose without resort to the *BP Australia* factors.**
>
> (b) **The *BP Australia* indicia are just that; as Lord Pearce recognised, they are not necessarily determinative.**
>
> (c) **In the end, as all the authorities indicate, the answer will depend on a close examination of the facts of the particular case** and the character of the particular payment in order to ascertain the nature and purpose or effect of the relevant expenditure.
>
> (d) In essence there needs to be a sufficient relationship or connection between the expenditure (or loss) and the income or capital, as the case may be. It is the object or effect of any given payment that will be determinative. [Emphasis added]

10 *CIR v Trustpower Ltd* [2015] NZCA 253.

11 *Hallstroms Pty Ltd v FCT* (1946) 72 CLR 634 (HCA) and *Commissioner of Taxes v Nchanga Consolidated Copper Mines* [1964] AC 948 (PC) at 960 as cited in *Trustpower* at [55].

12 *BP Australia Ltd v FCT* [1966] AC 224 (PC).

13 *Sun Newspapers v FCT* (1938) 61 CLR 337 (HCA).

14 *Trustpower* at [59].

45. The Court of Appeal in *McKenzies* also noted the Privy Council decision in *BP Australia* had been recognised in a New Zealand context in *LD Nathan*[15] and *Buckley & Young*.[16]

46. From these leading cases, seven tests, factors or indicia have been identified to assist in deciding whether expenditure is capital or revenue in nature (the *BP Australia* factors). The courts have considered some of these tests to be more relevant than others. In addition, the tests may point in different directions when applied. Also, Lord Nicholls of Birkenhead noted in *Auckland Gas* (PC) that the tests should be applied in such a way that the dominant features that guided the conclusion can be identified.[17]

47. The seven tests, which are discussed below are:

- the need or occasion for the expenditure;
- whether the expenditure is recurrent;
- whether the expenditure is a once and for all payment producing assets or advantages that are of an enduring benefit;
- whether the expenditure is on the business structure or the business process;
- whether the expenditure creates an identifiable asset;
- whether the source of the payment is from fixed or circulating capital; and
- how is the expenditure treated according to the ordinary principles of commercial accounting.

48. The **need or occasion for the expenditure** test looks at the principal reason or need for incurring the expenditure. The object of the expenditure is decided by looking at the reason or need for making the expenditure and not at the actual thing achieved. Using this test accurately is important because it often forms the basis for applying the other capital or revenue tests. In the context of repairs and maintenance expenditure it is an important test because it focuses on why the work was done in the manner it was.

49. **Whether the expenditure is recurrent** involves considering whether the expenditure is recurrent or a once and for all payment. Recurring expenditure, which meets ongoing demands, is usually considered part of the cost of ordinary business operations and characterised as revenue outlays. One-time expenses are more likely to be capital expenditure. In the context of repairs and maintenance expenditure, regular, recurrent repairs and maintenance work is likely to be revenue expenditure. However, the usefulness of the once and for all test is limited as a capital indicator in some circumstances. This is because, repair work, by its nature, is often unplanned or the result of unexpected damage, so may not be recurrent.

50. Under the test of **whether the expenditure is a once and for all payment producing assets or advantages that are of an enduring benefit**, expenditure is regarded as capital where it brings into existence an asset or advantage for the enduring benefit of the business. This test is one of the more relevant and persuasive tests for deciding whether expenditure is on capital or revenue account. However, applying this test to repairs and maintenance expenditure can be difficult because almost every repair provides some form of enduring benefit. The Commissioner considers a more relevant question is the one developed by the courts in the repairs and maintenance context as to whether the work done has changed the character of the asset being worked on. Altering the character of an asset usually produces an advantage of an enduring benefit. This "change of character" test is discussed in more detail later at [103].

51. The test of **whether the expenditure is on the business structure or the business process** distinguishes between expenditure on the business structure set up to earn profit and expenditure on the business process (ie, how the business operates to get regular returns through regular outlays). This is one of the more relevant and persuasive tests for deciding whether expenditure is capital or revenue. For repairs and maintenance expenditure, the focus is on the asset being worked on that will form part of the business structure. This test may be relevant in a repairs and maintenance context, particularly where the asset is an integral part of the business and the loss or enhancement of that asset would affect the business structure.

15 *CIR v LD Nathan and Co Ltd* [1972] NZLR 209 (CA).

16 *CIR v McKenzies New Zealand Ltd* (1988) 10 NZTC 5,233 (CA) at 5,236. See also *Christchurch Press Co Ltd v CIR* (1993) 15 NZTC 10,206 (HC) where Gallen J adopted the principles from *BP Australia* and which Richardson J summarised in *McKenzies*.

17 *Auckland Gas Co Ltd v CIR* (2000) 19 NZTC 15,702 (PC) at 15,707.

52. The test of **whether the expenditure creates an identifiable asset** shows that expenditure is on capital account where an asset of a capital nature has been acquired or where money is spent on improving an existing asset or making it more useful. Work done to an existing asset sometimes results in a new identifiable asset. For example, where the work done results in the reconstruction, replacement or renewal of the whole or substantially the whole of the asset. Similarly, a new identifiable asset may arise where the work done involves the alteration or extension of an asset.

53. The test of **whether the source of the payment is from fixed or circulating capital** focuses on the source of funds to pay for the expenditure. Under this test, expenditure made from circulating capital (that is, capital that returns to the business as a result of the business's trading operations) is more likely to be revenue in nature. This test is not as useful as other tests. This is because taxpayers can easily choose between financing expenditure from circulating capital or from fixed capital, despite the nature of the expenditure financed. Also, this test has been questioned judicially.[18] For repairs and maintenance expenditure, the test is less relevant because how work is funded does not reliably indicate its nature.

54. The test of **how the expenditure is treated according to the ordinary principles of commercial accounting** is helpful but is not usually decisive because tax and accounting have different aims and their treatments can differ. This test often supports conclusions from the other tests but is not conclusive by itself. The Commissioner notes that the accounting and tax treatments for repairs and maintenance expenditure can vary greatly for some businesses, making it even more difficult to rely on this test alone.[19]

Applying the general principles in the context of repairs and maintenance expenditure

55. As mentioned above, some of the general principles and tests derived from them are more relevant than others in the context of repairs and maintenance expenditure. For example, when considering the deductibility of costs to remediate weathertightness issues in a residential rental property, Andrew J in *Lawrence* relied on the fixed capital, enduring benefit, business structure and lack of recurrence tests to decide whether the costs were capital or revenue in nature.[20]

56. However, in other cases where the courts considered the deductibility of repairs and maintenance expenditure, it is hard to see how the courts have applied the tests. More often, concepts mentioned in those cases are unique to repairs and maintenance expenditure.

57. Accordingly, while the application of the capital limitation to repairs and maintenance expenditure is a question to be decided on the general principles and tests set out above, the Commissioner considers the cases where repairs and maintenance expenditure has been specifically considered often provide the best guidance on what repairs and maintenance expenditure is deductible and what is not deductible.[21]

58. Those cases show that the courts use a two-step approach when deciding whether repairs and maintenance expenditure is capital or revenue in nature:

    - Step 1: Identify the asset that has been worked on.
    - Step 2: Consider the nature and extent of the work done to that asset.

59. The next sections discuss these two steps. However, some of the case law indicates that specific fact situations can affect the conclusions drawn from applying these steps. In particular, whether the expenditure is part of one overall project or related to a newly acquired asset. These specific situations are considered from [150].

18 See *Milburn NZ Ltd v CIR* (2001) 20 NZTC 17,017 (HC) at [48], *CIR v Fullers Bay of Islands Ltd* (2004) 21 NZTC 18,834 (HC) at [36] and *Trustpower* at [71]–[73].

19 See also *Trustpower* at [71] where the Court of Appeal noted this factor is "unlikely to be particularly significant or determinative".

20 *Lawrence v CIR* [2024] NZHC 905 at [87] and [88].

21 Until the 1993–94 income year, s 108 of the Income Tax Act 1976 allowed deductions for repairs and maintenance expenditure and there is a substantial amount of case law on its application. Following the 1976 Act's repeal, ss DA 1 and DA 2 now apply. The key difference is that there is now no provision to allow deductions on repairs or alterations that did not increase an asset's value, as previously allowed under s 108. Despite this difference, the Commissioner considers that cases decided under s 108 of the Income Tax Act 1976 still provide relevant guidance for determining the character of repairs and maintenance expenditure.

Step 1: Identify the asset being worked on

Introduction

60. To decide whether expenditure on repairs or maintenance work is of a capital or revenue nature the first step is to identify the asset being worked on. Lord Nicholls stated this in *Auckland Gas* (PC):[22]

> In order to decide whether work constitutes repair or replacement, the first step is to identify the object to which the test of repair or replacement is being applied. Frequently this is a straightforward exercise and the answer is obvious.

61. And, in the Court of Appeal in *Poverty Bay Electric Power Board,* Blanchard J stated:[23]

> Where a tax deduction is claimed for expenditure on property of the taxpayer it is necessary, in order to classify it *either* as repairs or maintenance *or* an improvement of a capital nature, first to determine what can fairly be said to have been the subject matter of the work. [Italics in original]

62. The courts have determined that identifying the asset being worked on is always a question of fact, involving matters of degree and impression. For example, in:

- *Auckland Trotting Club,* the Court of Appeal agreed with the view in *Phillips v Whieldon Sanitary Potteries*[24] that "there is no one line of approach to the problem that is exclusively correct";[25]
- *Auckland Trotting Club,* the Court of Appeal also agreed with the view in *Margrett*[26] where the court stated the decision is "essentially a question of fact and of degree";[27]
- *Hawkes Bay Power*, the High Court noted that determining what is the relevant asset is "a matter of degree and of the right conclusion to be drawn from the facts";[28] and
- *Case N8,* the Taxation Review Authority stated, "it is a question of fact, degree and impression as to what is included or excluded in an entity".[29]

63. Despite this, guidance on the test to apply at this step and the relevant factors to consider can be derived from case law, as discussed next.

The "entirety test"

64. As discussed below, the courts have variously described the approach to working out what is the asset being worked on as involving:

- considering what is the relevant "entirety";
- finding "a physical thing which satisfied a particular notion"; and
- identifying "the totality or entirety of the physical asset".

65. In the High Court of Australia decision in *Lindsay*,[30] Kitto J considered a ship repairer's slipway should be seen as an entirety by itself and not a subsidiary part of anything else. The slipway was a physical thing that satisfied a "particular notion", namely a physical thing that is used for landing and relaunching boats and ships for repairs. In reaching his conclusion, Kitto J stated:[31]

> But where the question is whether expenditure has been for repairs, and for the purpose of deciding that question one **asks what is the entirety which it is relevant to consider**, one is looking not for a profit-earning structure or entity, as such, **but for a physical thing which satisfies a particular notion**. [Emphasis added]

22 At 15,706.
23 *Poverty Bay Electric Power Board v CIR* (1999) 19 NZTC 15,001 (CA) at 15,006.
24 *Phillips v Whieldon Sanitary Potteries Ltd* (1952) TC 213 (Ch) per Donovan J at 219.
25 *Auckland Trotting Club (Inc) v CIR* [1968] NZLR 967 (CA) at 975.
26 *Margrett v The Lowestoft Water & Gas Co* (1935) 19 TC 481 (KB) per Finlay J at 488.
27 *Auckland Trotting Club* (CA) at 975 and 976.
28 *Hawkes Bay Power Distribution Ltd v CIR* (1998) 18 NZTC 13,685 (HC) at 13,701.
29 *Case N8* (1991) 13 NZTC 3,052 (TRA) at 3,070.
30 *Lindsay v FCT* (1961) 106 CLR 377 (HCA) at 384.
31 At 384.

66. Kitto J also stated it was necessary to consider whether the asset or property is an "entirety by itself" or whether it is a "subsidiary part of anything else":[32]

> I am of opinion that the No. 1 slipway ought to be considered, **for the purposes of the question I have to decide, as an entirety by itself, and not as a subsidiary part of anything else. It is separately identifiable as a principal, and indeed the principal, item of capital equipment,** so that in a discussion as to whether work done in relation to it constitutes a repair or a renewal in the opposed senses abovementioned, the subject matter in relation to which the choice of description is to be made is the slipway itself, and **not any larger thing or aggregation of things** of which it may be suggested to form part. [Emphasis added]

67. Kitto J considered it relevant to whether the slipway was "a physical thing which satisfies a particular notion" that it was:

- an "entirety by itself" and not a "subsidiary part of something else";
- separately identifiable as a principal item of capital equipment.

68. Richmond J adopted this "entirety test" in *Auckland Trotting* (CA). In this case, the taxpayer claimed a deduction under s 113(1) of the Land and Income Tax Act 1954 for expenditure on demolishing and replacing a trotting track on the same site as repairs or alterations to the club's "premises". The taxpayer argued that the premises included the entire complex of buildings and improvements, not just the track. The Court of Appeal disagreed. Applying Kitto J's entirety test from *Lindsay* (HCA), it found the track was the relevant premises for evaluating the repair work.

69. Although the court in *Auckland Trotting* (CA) was considering how the work by the club applied to premises, it still had to decide what the entirety was before testing whether the work carried out was repairs. Therefore, the court's finding is still relevant in the context of repairs and maintenance expenditure under the current legislation.

70. In the Court of Appeal decision in *Auckland Gas* (which the Privy Council upheld), the court again adopted the entirety test.[33] Blanchard J, adopting the Court of Appeal's words in *Poverty Bay Electric Power Board* (when applying Kitto J's approach in *Lindsay* (HCA)), stated the correct way to identify the asset being worked on was "by inquiry into the totality or entirety of the physical asset in question".[34] The court considered the test does not focus on:

- a profit-earning structure or entity;[35] or
- the operational significance or economic value of the item (including whether it needs to be used with other things or systems to realise that value).[36]

71. And, in the *Auckland Gas* Privy Council decision, it was accepted that the relevant asset being worked on was the taxpayer's "distribution system". However, the Privy Council warned that this was not an abstract concept (ie, a means of distributing gas) but one that could be considered a functional entity separate from its physical components.[37]

72. In *Poverty Bay Electric Power Board* (CA) Blanchard J, pointed out there is a danger of distortion if too large or too small a subject is identified as the object of the expenditure. He stated:[38]

> There is always a danger of distortion if too large or too small a subject matter is identified. If a subsidiary part of an asset is regarded as the subject matter and that part has been replaced, there might be a tendency to classify what has occurred as a matter of capital. That could lead to an absurd result, for example, treating the replacement of a car tyre or a spark plug as a capital improvement when, if the subject matter is correctly seen as the whole of the motor vehicle, the work is obviously a repair involving a replacement of a mere component, even a vital component and even if an improved or modified version of that component is substituted.

32 At 385.

33 *Auckland Gas Co Ltd v CIR* (1999) 19 NZTC 15,011 (CA) at 15,019. See also *Hawkes Bay Power* at 13,701.

34 At 15,019.

35 At 15,019.

36 At 15,026.

37 At 15,707.

38 At 15,006.

How the courts have applied the entirety test

73. The Commissioner considers the principles for identifying assets for repairs and maintenance purposes are the same as those for identifying an item of property for depreciation purposes. In a repairs and maintenance context, expenditure is usually incurred for work done and the entirety test is applied to identify the object of that work. In a depreciation context, the expenditure may also be for work done or may be more in the nature of acquisition costs. In both situations, the analysis is dictated by the expenditure and what it sought to achieve from a practical business perspective.

74. This means, generally, the tangible asset considered for repairs and maintenance purposes is the same as the item of property being depreciated. Provided, that is, the other conditions relating to when an asset is also an item of depreciable property are met. One of those conditions is that the taxpayer owns the item of property. If the taxpayer does not own the entire object of the work carried out, a deviation from the general rule may arise where the asset for repairs and maintenance and the asset for depreciation purposes is not the same. For example, a unit owner's share of costs for work carried out on the apartment block in which their unit is located may be characterised on the basis that the block is the object of the work, whereas only the taxpayer's unit can be an item of depreciable property. If, however, the taxpayer renovated their unit, then the object of the work and the item of depreciable property would align.[39]

75. The courts have considered several factors when considering what is the relevant asset in other contexts to repairs and maintenance, primarily in relation to depreciation.[40]

76. Firstly, factors that might suggest the item under consideration **is** the relevant asset are where the item:

- is physically distinct from a wider asset of which the item might be a part;
- is functionally complete (to some degree); or
- varies the function of another item.

77. Secondly, factors that might suggest the item under consideration **is not** the relevant asset are where the item:

- has a physical connection with other items;
- is part of an integrated system; or
- is a necessary part to complete something else.

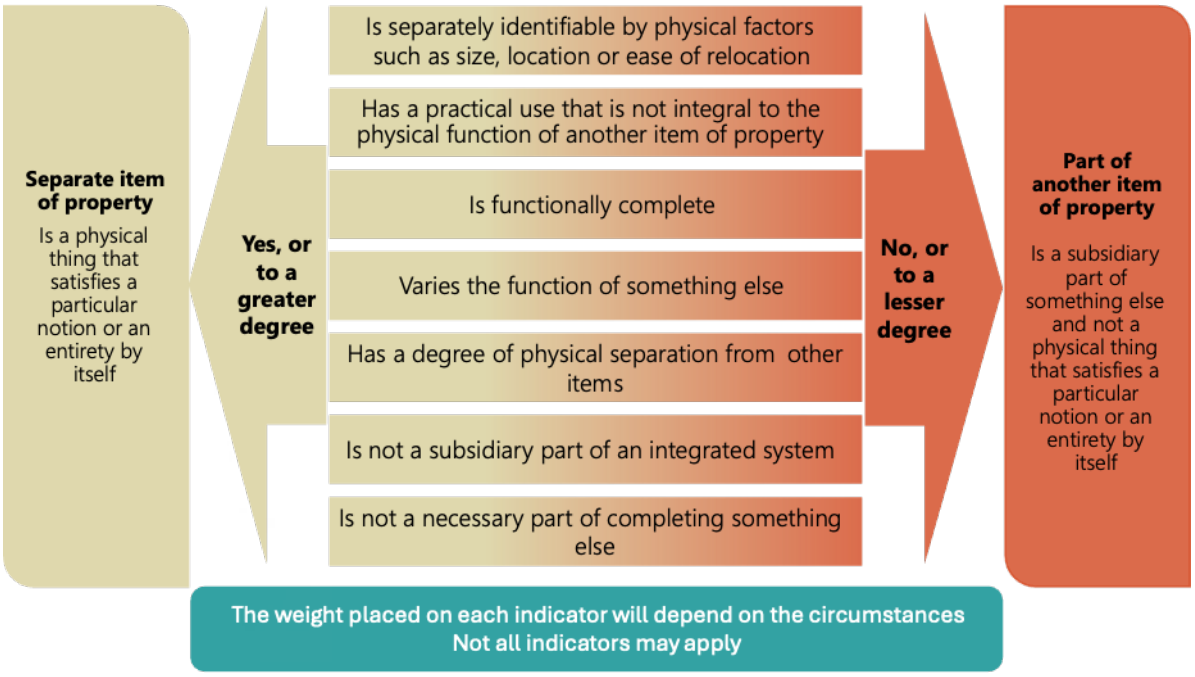
78. The relationship between these factors is represented in Figure | Hoahoa 2.[41]

39 Although the unit could be an item of depreciable property, it would attract depreciation at 0%.

40 The Commissioner has published guidance on the identification of the relevant item of property in the context of the depreciation rules: IS 25/03: Income tax – identifying the relevant item of property for depreciation purposes *Tax Information Bulletin* Vol 37, No 2 (March 2025): 8. These factors are the same as those included in IS 25/03.

41 Reproduced from IS 25/03 (see n 40).

Figure | Hoahoa 2: Factors to consider when identifying the relevant asset



79. The courts' consideration of the entirety test and these factors in the context of repairs and maintenance expenditure is discussed in the Appendix. These cases highlight the following key points about identifying the asset being worked on:

- It may be helpful to determine whether the item can be separately identified by physical factors, such as its location or size (*Lindsay* (HCA), *Hawkes Bay Power*, *O'Grady*,[42] *Samuel Jones*[43] and *Margrett*).
- An item that is physically divisible and distinct from other things might suggest it is a single asset (*Case F67*,[44] *O'Grady*, *Samuel Jones* and *Margrett*).
- A physical connection between component parts is often relevant to finding a single asset (*Auckland Gas* (CA)).
- Subsidiary parts of an integrated system should be considered part of that system rather than assets in their own right (*Poverty Bay Electric Power Board* (CA) and *Hawkes Bay Power*).
- Determining an item's function may also be helpful when identifying the relevant asset being worked on (*Auckland Gas* (CA), *Poverty Bay Electric Power Board* (CA), *Hawkes Bay Power* and *Case N8*).
- A smaller item that is integral to a larger asset's ability to physically function is not likely to be the relevant asset (*Hawkes Bay Power*). Conversely, an item that can operate separately is more likely to be the relevant asset (*Poverty Bay Electric Power Board* (CA) and *Hawkes Bay Power*).

Items attached to a building and commercial fit-outs

80. Another factor, of particular relevance to repairs and maintenance expenditure for buildings such as rental properties, will be the question of whether the object of the work is the building proper or a separate item or chattel not forming part of the building. Similarly, a "commercial fit-out" is treated separately from a building and repairs and maintenance issues follow this treatment.

81. A three-step test can be applied for distinguishing between buildings and items attached to a building:

1. *Attachment:* Is the item attached or connected to the building? If not, it is a separate asset.
2. *Integral part:* Is the item integral such that the building would be incomplete or unable to function without it? If yes, it is part of the building.
3. *Fabric:* Is the item built-in or attached in such a way that it is part of the "fabric" of the building? If yes, it is part of the building; if not, it is a separate asset.

42 *O'Grady (HM Inspector of Taxes) v Bullcroft Main Collieries Ltd* (1932) 17 TC 93 (KB).

43 *Samuel Jones & Co (Devondale) Ltd v IRC* (1951) 32 TC 513 (IH (1 Div)).

44 *Case F67* (1983) 6 NZTC 59,897 (TRA).

82. And a commercial fit-out comprises items:

- Attached to a commercial building that are non-structural and not used for weatherproofing.
- That must not be used inside a dwelling within the commercial building.
- That are plant attached to a commercial building, but not structural items.
- That may be in shared or common spaces outside of residential/dwelling areas in a commercial building.

Further guidance on these matters can be found in the Commissioner's publications IS 10/01, QB 20/01, and IS 22/04.[45]

Key points for identifying the asset being worked on

83. The key points for identifying the asset are:

- The first step in considering whether repairs and maintenance expenditure is deductible is to identify the object to which the test of repair or replacement is being applied. In other words, what is the relevant asset?
- It is always a question of fact, degree and impression as to what is included or excluded in an entity or asset.
- Identifying the asset is about identifying a physical thing that satisfies a particular notion (the entirety test).
- When considering whether something is a physical thing that satisfies a particular notion, the courts are guided by whether the thing would be:
  - an entirety by itself and not a part of an asset or aggregation of things forming an asset; or
  - separately identifiable as a principal item of capital equipment.
- Identifying the relevant asset is not about identifying a profit-earning structure or entity.
- The fact a physical thing realises its economic value only when used with other things or business systems does not prevent it being regarded as a separate asset.
- A single asset may consist of interdependent parts. A risk of distortion exists if too large or too small a subject matter is identified. For example, if a subsidiary part of an asset is regarded as the subject matter and that part is replaced, there might be a tendency to classify what has occurred as a matter of capital. Conversely, if the subject matter is too broad, then every replacement of a single unit that forms part of the total subject matter could be seen as a repair to the whole and a revenue matter.
- The asset for repairs and maintenance purposes is generally the same item as the item of property for depreciation purposes.
- For buildings, a key consideration is determining whether expenditure relates to the building itself or a separate item or chattel that does not form part of the building.
- Commercial fit-outs are treated as separate from the building.

Examples 3–5: identifying the asset being worked on

84. How to identify the asset being worked on is illustrated in Example | Tauira 3 to Example | Tauira 5.

Example | Tauira 3 – Reconditioned car engine (subsidiary part of a larger asset)

Frank is an owner-operator taxi driver. He has been driving the same taxi for 5 years. Frank has had it serviced regularly, but his mechanic recently informed him that the engine is now seriously worn and should be replaced with a reconditioned engine.

The asset in this case is the taxi and not the engine. The engine is a subsidiary part of that asset and is physically and functionally connected to the taxi. The engine is necessary to complete the taxi and is integral to its operation.

45 IS 10/01: Residential rental properties – depreciation of items of depreciable property, *Tax Information Bulletin* Vol 22, No 4 (May 2010): 16; QB 20/01: Can owners of existing residential rental properties claim deductions for costs incurred to meet Healthy Homes standards? *Tax Information Bulletin* Vol 32, No 7 (August 2020): 126 and IS 22/04: Claiming depreciation on buildings, n 3.

Example | Tauira 4 – Loan trailer (asset as entirety)

Hedgy Landscape Supplies owns trailers for making deliveries and for customers to use. One trailer's deck needs repair.

The asset in this case is the trailer being repaired. It is an entirety in itself and not a subsidiary part of something else. The trailer has all the necessary parts to function and is a composite whole. While it is temporarily connected to other assets when in use (eg, customers' vehicles), the trailer varies the function of the other assets, rather than being necessary to complete them.

Example | Tauira 5 – Residential rental unit (part of a larger asset)

Jonas owns a residential rental unit that is part of a free-standing block of residential units in a complex comprising several similar blocks of units. The block of units in which Jonas owns his unit needs remediation work to resolve weathertightness issues that are not present in the other blocks within the complex. The body corporate arranges for the work to be carried out, which is paid for by special levies payable by each unit holder in the affected block. Each unit holder's levy is determined by assessing how much of the total cost relates to each unit in the block.

Because of the disruption caused by the remediation work, Jonas arranges, at the same time and independently of the work arranged by the body corporate, for additional work to be carried out on the interior of his unit. This work involves the extensive replacement and remodelling of his apartment's interior, including the replacement of the kitchen and bathroom fixtures and fittings and redecoration of the entire unit.

The asset in this case depends on what is the object of the work. There is no single overall project of work but two independent projects meaning the object of the work in each case could differ.

For the weathertightness work arranged by the body corporate, the block of units is the object of the remediation work carried out. The work carried out was not confined to any single unit within the block, but it was confined to that block as it did not affect the other blocks in the complex. The block of units are physically and largely functionally distinct from other blocks within the complex.

Accordingly, the relevant asset is not the complex of apartment blocks even though the blocks may be located on one legally defined area of land. Also, the separate legal ownership of each apartment in the block does not necessarily mean that, in respect of the remediation work, each apartment is a separate object of the work. There is a single project and a single object of that work, being the block of units.

As Jonas does not own the entire block of units, this is an example of the special case where the object of the work and the item of depreciable property do not entirely match.

For the work arranged and carried out by Jonas on the interior of his unit, the object of the work is his unit. Unlike the weathertightness work, this work did not involve carrying out work outside the unit's physical boundaries. While physically attached to other units, the unit is separated by its own internal walls, allowing it to operate as a residential rental unit.

On balance, the unit can be considered sufficiently functionally distinct so that it can, in respect of this work, be considered the relevant entirety despite its physical connection to other units. For this work, the object of the work and the item of depreciable property are the same.

Step 2: Consider the nature and extent of the work done to the asset

Introduction

85. Once the relevant asset is identified, the second step in deciding whether the capital limitation applies to repairs and maintenance expenditure is to consider "the nature and extent of the work carried out to the physical asset" as this is "determinative of the character of the work".[46] If the nature and extent of the work done to the asset shows the expenditure is capital in nature, the capital limitation in s DA 2(1) denies a deduction for the expenditure.

46 Per Lord Nicholls in *Auckland Gas* (PC) at 15,709.

Two key questions arise for consideration under step 2

86. The general approach to distinguishing between capital and revenue expenditure was discussed from [41]. When courts apply this approach in the context of repairs and maintenance expenditure, they consider two key questions about the nature and extent of the work done to an asset:

    - Has the work led to the asset's reconstruction, replacement or renewal, either entirely or substantially? If yes, the cost is considered capital expenditure.
    - Has the work gone beyond repairs and changed the asset's character, even though it does not involve the asset's entire or substantial reconstruction, replacement or renewal? If yes, the cost is also considered capital in nature.

87. Therefore, step 2 focuses on two overlapping aspects of the work, being its extent and nature:

    - the extent of the work, primarily to help determine whether it has led to the asset's reconstruction, replacement or renewal, either entirely or substantially (question 1 above); and
    - the nature of the work, primarily to help determine its likely effect on the asset and whether it has gone beyond repairs and changed the asset's character (question 2 above).

88. The courts consider several factors are relevant to determining the answers to these questions. These are discussed further from [107].

89. In addition to these two key questions, some specific situations involving repairs and maintenance expenditure need to be kept in mind when applying step 2 because they may have a bearing on any conclusions reached (eg, where there is one overall project). These specific situations are discussed from [150].

Step 2 is applied to the work actually carried out

90. It is important to note that the analysis of the nature and extent of the work carried out under step 2 is applied to the expenditure that was, in fact, incurred. Repairs and maintenance issues can be resolved in many ways, such as restoring an asset to its as new condition, replacing substantial parts, or reconstructing it with new materials that may be different from the original materials. For income tax purposes, the expenditure's deductibility depends on how the issues were resolved in practice. It relies on the nature and extent of the work actually done to the asset.

91. This means no deduction is possible for a hypothetical notional amount not actually incurred that might have been spent on repairs if the work been done differently (ie, "notional repairs"). Blanchard J made this clear in *Poverty Bay Electric Power Board* where he discussed the decision of the Court of Appeal in *Auckland Trotting*. Blanchard J stated:[47]

> **In *Auckland Trotting Club (Inc) v C of IR* [1968] NZLR 967 at p 980 *Richmond* J said that no part of the money spent on constructing the new trotting track was, in fact, spent on repairs and it was not possible to treat part of it as notionally spent on repairs when that is not what happened.** *North* P and *Turner* J expressed their agreement (p 977). The Court adopted the reasons of *Finlay* J in *Margrett (HM Inspector of Taxes) v Lowestoft Water and Gas Co* (1935) 19 TC 481 at pp 488–489 and of *Kitto* J in *FC of T v Western Suburbs Cinemas Ltd* (1952) 86 CLR 102 at pp 107–109. At p 107 *Kitto* J said:
>
> > ... when a taxpayer has two courses open to him, one involving an expenditure which will be an allowable deduction for income tax and the other involving an expenditure which will not be an allowable deduction, and for his own reasons he chooses the second course, he cannot have his income tax assessed as if he had exercised his choice in the opposite way. Section 53 is concerned with expenditure which was in fact incurred, not with expenditure which could have been incurred but was not.
> > ...
>
> To similar effect is the judgment of this Court in *Colonial Motor Co Ltd v C of IR* (1994) 16 NZTC 11,361.
>
> **We agree that it is not possible to claim as expenditure on a repair a payment which has not actually been expended for that purpose.** [Emphasis added]

Work that entirely or substantially reconstructs, replaces or renews the asset

92. Deciding whether repairs and maintenance expenditure is revenue or capital in nature, requires considering the work done primarily in terms of its extent but also in terms of its nature and whether it involves reconstructing, replacing or renewing the asset either entirely or substantially. If so, the expenditure is capital in nature.

47 At 15,008.

93. One of the earliest authorities supporting this view is *Lurcott*.[48] In this case, the court considered whether the tenant of a leased building was required to pay for the cost of replacing a wall under the lease terms that obligated them to carry out "repairs". Although this case does not address the income tax distinction between capital and revenue expenditure, the repair obligation can reasonably be considered as relating to what would be revenue expenditure in an income tax context.

94. *Lurcott*, confirms that reconstructing, replacing or renewing an asset, either entirely or substantially, does not involve repairs. Accordingly, it can be implied that such costs are capital in nature. Lord Buckley commented on the difference between a repair and a renewal:[49]

> "Repair" and "renew" are not words expressive of a clear contrast. Repair always involves renewal; renewal of a part; of a subordinate part. A skylight leaks; repair is effected by hacking out the putties, putting in new ones, and renewing the paint. A roof falls out of repair; the necessary work is to replace the decayed timbers by sound wood; to substitute sound tiles or slates for those which are cracked, broken, or missing; to make good the flashings, and the like. Part of a garden wall tumbles down; repair is effected by building it up again with new mortar, and, so far as necessary, new bricks or stone. **Repair is restoration by renewal or replacement of subsidiary parts of a whole. Renewal, as distinguished from repair, is reconstruction of the entirety, meaning by the entirety not necessarily the whole but substantially the whole subject-matter under discussion.** [Emphasis added]

95. New Zealand courts have recognised the distinction between a repair and a renewal as outlined in *Lurcott* in the context of income tax and repairs and maintenance expenditure. For instance, in the Supreme Court decision in *Auckland Trotting*, Moller J, having earlier referenced the passage from *Lurcott*, determined the cost of constructing what was substantially a new trotting track in place of what was substantially the old one, was not a repair, so was capital expenditure.[50]

96. *Lurcott* is also referenced in a New Zealand income tax repairs and maintenance context in the Taxation Review Authority decision of *Case N8* and in the High Court decision of *Lawrence*.[51]

97. Goddard J also drew a distinction between repairing an asset and renewing it in *Hawkes Bay Power*. She determined the work the taxpayer did to its urban residential power distribution system, although completed incrementally over many years, constituted a total reconstruction project. The project resulted in the creation of a new asset and involved capital expenditure. She concluded:[52]

> The result in the present case is that substantially the whole of the urban residential distribution system has been placed underground. It follows therefore that the urban residential system is a new and different distribution system; not a repaired system. Thus, Hawkes Bay Power has acquired by its expenditure a "new" underground urban residential distribution system.

98. Also, in *Case N8*, the Authority considered there was a renewal or replacement of such substance of the relevant asset (a concrete batching plant) that it amounted to a capital reconstruction. This was despite the fact that most of the parts renewed could be considered as deductible repairs if looked at item by item (see appendix from [223]).

99. As highlighted in *Auckland Trotting* and *Hawkes Bay Power*, capital expenditure is not limited to where an asset is entirely reconstructed, replaced or renewed. It can also arise when *substantially the whole* of the asset undergoes reconstruction, replacement or renewal.

48 *Lurcott v Wakely and Wheeler* [1911] 1 KB 905.

49 At 923–924.

50 *Auckland Trotting Club v CIR* [1968] NZLR 193 (SC) at 200 and 205. Moller J's decision was upheld in the Court of Appeal (*Auckland Trotting Club (Inc) v CIR* [1968] NZLR 967).

51 *Case N8* at 3,067–3,068 and *Lawrence* at [63].

52 At 13,707.

100. This point is further shown by the decision in *Case J92*, which involved repairs and maintenance work on a farm homestead.[53] While some structural parts of the house were retained, there was substantial replacement of the framework, linings, interior joinery, plumbing and wiring, along with re-piling and extensive exterior recladding. The taxpayer argued the original homestead had not been completely replaced, as much of the original structure remained. This distinguished it from the new track constructed in *Auckland Trotting*. However, Judge Barber found the work done was so extensive it could not be regarded as repairs. The work involved the complete reconstruction of the homestead. Barber J stated:[54]

> After a careful analysis and consideration of the evidence I find the building work undertaken by the objector on the homestead was so extensive that it cannot be regarded as "repairs or alterations". The work involved the complete reconstruction of the homestead and, in my view, the expenditure was of a capital nature and was incurred in the improvement of the premises from a capital point of view.

101. The work done to the asset must be considered in its entirety to decide whether it is so substantial that the whole or substantially the whole of the asset is reconstructed, replaced or renewed.[55] This assessment includes work done over multiple income years, as seen in *Auckland* Gas (CA), *Poverty Bay Electric Power Board* (CA) and *Hawkes Bay Power*. In *Auckland Gas* (CA), Blanchard J noted:[56]

> The work done in a particular year is properly to be seen in its overall context, which was of an ongoing programme to replace all the low-pressure system as a conveyor of gas. The question is: what was being achieved? A taxpayer cannot by artificially treating as separate works portions of an overall programme done in separate income years deny the reality or minimise the extent of what is being effected.

102. Deciding whether the work done to the asset is so extensive that the whole or substantially the whole of the asset is reconstructed, replaced or renewed is challenging. However, this assessment is necessary, especially when components of an asset are renewed rather than merely kept in a serviceable condition. Factors the courts have considered in this context are discussed further from [107].

Work that goes beyond repairs and changes the asset's character

103. In *Auckland Gas* (PC), Lord Nicholls explained that you cannot always assume the cost of work done to an asset is deductible as "repairs" if it does not result in a reconstruction, renewal or replacement of the whole or substantially the whole of the asset. The cost of work done may be capital in nature where it changes the asset's character. Therefore, it may be necessary to also consider the work done, primarily in terms of its nature, but also in terms of its extent, to determine whether it changes the asset's character.

104. In *Auckland Gas* (PC) Lord Nicholls stated:[57]

> The nature of some objects and their component elements is such that replacement of one or more components will not necessarily be regarded as a repair of a larger object. **This is particularly so if the replaced element differs from the damaged original in such a way as to change the character of the whole.** …
>
> … [S]ometimes repair may not be the appropriate description of work even though it falls far short of being a replacement of substantially the whole of the relevant subject-matter. **The effect of the work on the character of the object is also an important consideration.**
>
> This is explicit, or implicit, in several decided cases. In *W Thomas & Co Pty Ltd v Commissioner of Taxation of the Commonwealth of Australia* (1965) 115 CLR 58 at p 72, *Windeyer* J observed that **repair "involves a restoration of a thing to a condition it formerly had *without changing its character*"** (emphasis added). In *Highland Railway Co v Balderston (Surveyor of Taxes)* (1889) 2 TC 485 parts of the main railway track were re-laid, not after their existing fashion, but with steel rails and heavier chairs. The Court of Session held this **substitution was a material alteration and great improvement, and contrasted this with taking away any worn rails and renewing them along the line: that "would not alter the character of the line"** (see the Lord President, Lord Inglis, at p488). The Judicial Committee applied this dictum in *Rhodesia Railways Ltd v Collector of Income Tax, Bechuanaland Protectorate* [1933] AC 368 where **the cost of relaying a railway line so as to restore it to its former condition was held to be a legitimate charge against income**. Consistently with this, in *Mitchell v BW Noble Ltd* [1927] 1 KB 719 at p 729, Rowlatt J observed that **replacement of a railing which perpetually falls down or needs painting with a brick wall would be capital expenditure**. In *FC of T v Western Suburbs Cinemas Ltd* (1952) 86 CLR 102 **a dangerous ceiling in a cinema was replaced with a new and better ceiling. Kitto J regarded the work as different in degree and kind from the type of repairs properly allowed for in the working expenses of a theatre business**. [Emphasis added]

53 *Case J92* (1987) 9 NZTC 1,518 (TRA).

54 At 1,522.

55 See for example, *Case N8*.

56 At 15,024.

57 At 15,706.

105. As noted in *Auckland Gas* above, a repair restores an asset to its former condition prior to the work being carried out without changing its character. An asset's character is changed when the work done improves or enhances the asset in some way or makes it more advantageous. However, almost any repair work to an asset will result in some degree of improvement to that asset.[58] To be capital in nature the work done must change the asset's character in the sense of going beyond restoring it's former condition.

106. Accordingly, if the work done to an asset changes its character, the cost is considered capital expenditure. If the work does not change the asset's character and is not a reconstruction, replacement or renewal of the whole or substantially the whole of the asset, the cost is considered revenue in nature and deductible.

Factors the courts have considered relevant under step 2

107. The courts have considered some factors that are relevant when considering whether the work has led to the asset's reconstruction, replacement or renewal, either entirely or substantially or whether the work has changed the asset's character. In some cases, these factors are more relevant to the former than the latter or vice versa.

Scale of the work done

108. Several repairs and maintenance cases refer not only to the "extent" of the work but also the "scale" of the work (or the nature and scale of the work).

109. Extent refers to the degree, range or scope of something, often describing how far something reaches. Scale refers to the relative size or level of something, especially in comparison to something else. Hence, it is possible for work of a small scale to be carried out to the full extent of an asset, while larger-scale work might be carried out to a key portion or portions of an asset.

110. In *Auckland Gas,* the Privy Council noted that new pipes were inserted into 380 km of the network's cast-iron mains representing 23% of the total mains network. In addition, new pipes were inserted into 150 km or 32% of the steel services. The Privy Council considered this was a significant portion of the gas distribution system, stating:[59]

> If a significant portion of this series of linked pipes is effectively abandoned and replaced wholesale with new pipes, the work may readily go beyond what would normally be regarded as repair of the existing system. This is especially so if the new pipes are made of materials which perform differently from the old ones. **The work may be of such a nature and scale as to change the character of the existing system.** [Emphasis added]

111. *Case L68* concerned work on two fishing boats, one of which was refitted.[60] Judge Keane considered the scale of the refit meant the expenditure was capital in nature. He held:[61]

> Whether expenditure is for "repairs or alterations", or is more substantial and capital in nature, appears to depend on the scale and significance of the work done, when related to the asset to which it occurs. **The larger and more significant the work, relative to the whole, the more probable it is that capital expenditure is involved.** …
>
> The refitting of the "S" seems much more to me than an accumulation of repairs. **The sheer scale of what was done tells against the possibility that it was routine.** It was an extraordinary event in the life of the vessel. There was nothing piecemeal about what was done. The whole capital entity was affected. Entire aspects of the fabric were replaced. The vessel was restored in the fullest sense, in some respects with more modern materials, to a new and much extended life. The expenditure seems to me to have been capital in nature. [Emphasis added]

112. In *Lawrence,* Andrew J noted the scale of the remediation works done to the building was significant with the work affecting nearly every part of the property.[62] While the significance of the work may relate to its scale, the scope of the work affecting nearly every part of the building arguably relates to its extent. However, Andrew J referred to the "nature and scale" of the remediation work on the building rather than its "nature and extent".[63] Accordingly, the courts appear sometimes to use "extent" and "scale" interchangeably.

58 See *W Thomas & Co Pty Ltd v FCT* (1965) 115 CLR 58 (HCA) at 72.
59 At 15,707.
60 *Case L68* (1989) 11 NZTC 1,398 (TRA).
61 At 1,401.
62 At [113].
63 At [86].

113. Despite this, it seems that nature, extent and scale are distinct aspects of the work done that need to be considered when determining whether work has gone beyond repairs.

Significance of the work to the asset

114. An aspect of the scale of the work is the significance of the work in relation to the asset. The more important or essential the part of the asset being worked on or replaced compared with the whole of the asset, the more likely the expenditure is of a capital nature.

115. For example, in *Western Suburbs Cinemas*, Kitto J referred to the fact the ceiling was a "major and important part of the structure of the theatre" when reaching the conclusion that the expenditure was capital.[64]

116. In *Case N8,* regarding the deductibility of repairs and maintenance expenditure on a cement manufacturing plant, Judge Bathgate found it significant in his analysis of the work done to the plant that the mixer was replaced with a more modern one. The mixer was the most significant item amongst the many replaced and central to the operation of the concrete-making process.

117. In relation to the mixer, Judge Bathgate drew an analogy with a motor car.[65] He considered replacing a spark plug in the car's engine as likely to involve revenue expenditure reasoning that the relevant asset is the car, not the individual spark plug. In that context, a spark plug is not as significant as components like the gearbox or engine, which—particularly in the case of the engine—might be more likely to involve capital expenditure if replaced.[66] Judge Bathgate considered the mixer to be more analogous to the gearbox or engine in terms of its significance.

118. And Andrew J in *Lawrence* stated that:

> [113] The more significant or integral the part of the asset being worked on or replaced relative to the whole asset, the more likely the expenditure is to be capital.

Use of different materials

119. One factor that could mean the asset's character is changed is if the work done uses different materials to the original materials.

120. In *Auckland Gas*, the Privy Council relied on its decision in *Highland Railway*,[67] which was also applied in *Rhodesia Railways*.[68] In *Highland Railway,* the court decided alterations made to the company's main railway line changed its character, making the expenditure incurred capital in nature. The court held:[69]

> Then when we come to the question of the alteration of the main line itself, it must be kept in view that this is not a mere relaying of the line after the old fashion; it is not taking away rails that are worn out or partially worn out, and renewing them in whole or in part along with the whole line. **That would not alter the character of the line**; it would not affect the nature of the heritable property possessed by the Company. **But what has been done is to substitute one kind of rail for another, steel rails for iron rails.** Now that is a material alteration and a very great improvement on the corpus of the heritable estate belonging to the Company, and so stated is surely a charge against capital. [Emphasis added]

64 *FCT v Western Suburbs Cinemas Ltd* (1952) 86 CLR 102 (HCA) at 106.

65 At 3,063 and 3,073. See also the Appendix at [225] where the motor car analogy is raised at 3,070 of the decision in the context of identifying the relevant asset.

66 See, however, examples 6 and 7 of this statement, where, by itself, on those facts a like-for-like engine replacement is not considered to involve capital expenditure.

67 *Highland Railway Co v Balderston (Surveyor of Taxes)* (1889) 2 TC 485 (IH (1 Div)).

68 *Rhodesia Railways Ltd v Collector of Income Tax, Bechuanaland Protectorate* [1933] All ER Rep Ext 1,036 (PC).

69 At 488.

121. In *Rhodesia Railways*, the Privy Council distinguished *Highland Railway,* concluding that expenditure on repairs did not change the character of the railway line. Instead, the expenditure was found to be an ordinary incident of railway administration. Lord Macmillan stated:[70]

> The periodical renewal by sections of the rails and sleepers of a railway line as they wear out by use is in no sense a reconstruction of the whole railway and is an ordinary incident of railway administration. The fact that the wear although continuous is not and cannot be made good annually does not render the work of renewal when it comes to be effected necessarily a capital charge. The expenditure here in question was incurred in consequence of the rails having been worn out in earning the income of previous years on which tax had been paid without deduction in respect of such wear, and represented the cost of restoring them to a state in which they could continue to earn income. It did not result in the creation of any new asset; it was incurred to maintain the appellants' existing line in a state to earn revenue.

122. In *Rhodesia Railways*, Lord Macmillan commented on the differences between the two cases:[71]

> The contrast between the cost of relaying the line so as to restore it to its original condition and the cost of relaying the line so as to improve it is well brought out in the passage just quoted [ie, from *Highland Railway*, including the passage quoted at paragraph [120] of this statement], and while the former is recognised as a legitimate charge against income the extra cost incurred in the latter case in the improvement of the line is equally recognized as a proper charge against capital. In the present instance the renewals effected constituted no improvement; they merely made good the line so as to restore it to its original state.

123. As these two cases show, the materials used for repairs can have a bearing on determining the nature of repairs and maintenance expenditure. In one case, iron rails were replaced with steel rails of a greater weight and cost, and in the other, there was a like-for-like replacement of the rails.

124. This factor also arose in *Western Suburbs Cinemas* where work was carried out on a theatre's ceiling that was in a dangerous condition. The ceiling material had become dry, buckled and brittle with loose fixings. Replacement ceiling sheets were no longer available, but two comparable products were. However, the architect considered them to be unsatisfactory and believed repairing the ceiling was practically impossible. He recommended replacing it with fibrous plaster attached to new battens and ceiling joists. The plaster was harder, had a longer life and was better for moulding and decorating. The company considered both options and chose to replace the entire ceiling as the architect recommended. Kitto J concluded that the work done "did much more than meet a need for restoration". The new ceiling was "new and better", providing significant advantages over the old one. He found that "the new ceiling was an improvement to a fixed capital asset", so was capital expenditure.[72]

125. In *Case F78*, Judge Barber decided the replacement of a cracked fibre-cement sheet (fibrolite) roof of a rental property with a new type of tiled roof did not restore the asset to its original character but altered it.[73] The roof could have been repaired by replacing the damaged sheets of fibrolite but instead the owners chose to replace the entire roof with a "better" type of tiled roof. This meant the work was capital in nature.

126. In *Auckland Gas* (PC), Lord Nicholls also discussed using different materials in repairs and maintenance work. He noted that the use of newer and better technology may not in itself change the asset's character. He stated:[74]

> It often happens that, with improvements in technology, a replacement part is better than the original and will last longer or function better. That does not, of itself, change the character of the larger object or, hence, the appropriate description of the work.

127. However, Lord Nicholls also found that replacing a significant portion of the gas network with new polyethylene pipes, which performed differently from the old pipes, meant the work changed the gas system's character.[75]

128. Accordingly, using more modern and different materials does not necessarily mean the asset is improved, especially if the same or equivalent materials are no longer available or cannot be used because of changed legal or regulatory requirements (although see [142] regarding unsought benefits).[76]

70 At 1,039.

71 At 1,040.

72 At 106.

73 *Case F78* (1984) 6 NZTC 59,951 (TRA).

74 At 15,706.

75 At 15,708.

76 See also [180] regarding *Case 3/2025* [2025] NZTCRA 3 at [69]–[71].

129. However, where the materials used mean the asset is more useful or performs better, this may show the asset's character has changed. Choosing to use better materials over the same or equivalent ones that are available can result in a change in the asset's character, meaning the cost of the work is capital expenditure.

130. Regardless of whether different or more modern materials are used, where they are used extensively so the whole or substantially the whole of the asset is reconstructed, replaced or renewed, the expenditure is capital in nature. For instance, while replacing a single rotten wooden window in a building with a double-glazed aluminium one may not change the character of the entire building, more extensive replacement of all windows and doors may not only change its character but could also amount to a substantial replacement.

Factors that are rarely determinative on their own

131. Sometimes the courts have been asked to consider other factors, particularly when deciding whether the work done to an asset has changed its character. These include the effect of the work done on the asset's value, income-earning capacity, useful life, function or operating capacity. Other points to consider are the cost of the work and that work done to an asset can sometimes result in unsought benefits.

132. The cases show that these factors are rarely determinative on their own. Instead, the courts consider the overall effect of the work done on the asset to determine the character of the expenditure.

Increase in value

133. An increase in the asset's value by itself is not considered an essential element of repairs and maintenance expenditure being capital in nature. In *Poverty Bay Electric Power Board* (CA) Blanchard J commented:[77]

> It is worth observing also that it is hard to see the adding of value as an essential element in capital expenditure when restoration or repair work usually adds value to the object which is restored or repaired.

Income-earning capacity

134. The income-earning capacity of an asset also does not need to increase before the cost of the work done to the asset can be capital in nature. In *Highland Railway*, changes to the railway line were considered a "permanent improvement".[78] This was so, even though the company "derived no additional revenue from the outlay".[79] Similarly, in responding to the argument that the work carried out on a building did not result in any increase in the rental income it generated, Judge Barber concluded in *Case X26* that an increase in revenue is not a necessary result of a capital expense that improves a capital asset.[80] Therefore, comparisons of the income-earning capacity of the asset alone cannot always determine whether the work done involves capital expenditure.

Useful life, function and operating capacity

135. It might be suggested that if an asset's useful life or operating capacity does not increase, the cost of the work done is revenue expenditure on the basis that any increases in life or capacity must be capital in nature.

136. However, in the Court of Appeal decision in *Auckland Gas*, Blanchard J stated:[81]

> If a taxpayer faced with costly maintenance bills elects to rebuild the asset in question in a different way which results in a substantial change in its character, the cost cannot be written off for tax purposes as if it were merely an expenditure on maintenance work which was not actually done - even if what was spent may have been less than the cost of the maintenance. **Nor is it in point that the asset may give no greater performance and that its potential life-span may be no greater if in truth a different and substantially improved asset has been created by the expenditure**. [Emphasis added]

137. As noted at [90], it is the nature and extent of the work actually done that matters. If the work changes the asset's character, the cost is considered capital in nature, even if the asset's lifespan, operating function or capacity is no greater than had it simply been repaired.

77 At 15,008.

78 At 488.

79 Per Lord Macmillan when referring to *Highland Railways* in *Rhodesia Railways* at 1,040.

80 *Case X26* (2006) 22 NZTC 12,315 (TRA) at [45].

81 At 15,023.

138. Similarly, in the Privy Council decision in *Auckland Gas*, Lord Nicholls also noted that comparing an asset's functional position before and after work is done is not, by itself, a reliable guide to whether the cost of the work is capital or revenue in nature. He explained this was because a maintenance problem can be solved in more than one way:[82]

> The Court of Appeal held, and their Lordships agree, that Williams J [in the High Court] reached a conclusion which did not reflect the reality of the work done. In particular, his comparison of the functional position before and after was made at a level of abstraction which paid insufficient regard to the nature and extent of the operation carried out by Auckland Gas. A maintenance problem such as existed here may be capable of being solved in more than one way. It may be solved by work which would be regarded as a repair of the existing structure. Or it may be solved by scrapping all or much of the existing structure and providing a new one. **In overall functional terms the result may be much the same in the two cases, but that is not by itself a reliable guide.** If the latter alternative is chosen, the expenditure may well be of a capital nature. [Emphasis added]

Cost of the work done

139. In *Case N8*, Judge Bathgate considered the cost of the work done compared with the asset's value can indicate the nature of the expenditure. Consistent with the general capital or revenue principles, he suggested regular, small costs relative to the asset's value are more likely to be revenue in nature. In contrast, one-off substantial costs relative to the asset's value, are more likely to be capital in nature. He stated:[83]

> The expenditure would generally be deductible also if the expense is for an amount that is regularly incurred by reason of ordinary wear and tear, or **the expense is small and subordinate in nature in relation to the whole value of the asset involved**. On the other hand work resulting in a significant increase in value of the asset, a change in its character or kind, of an amount not regularly incurred, **or substantial in amount in relation to the value of the asset prior to the work, may be more likely to be capital expenditure** of the nature not allowed as a deduction under sec 108(1). [Emphasis added]

140. Judge Bathgate's decision shows how cost could be considered when assessing the nature and extent of the work done, by comparing the cost to the value of the asset. However, the Commissioner's view is that the courts do not consistently provide guidance on how to make such comparisons or their importance. Courts generally focus more widely on the overall scale of the work done to the asset, with cost being only one factor. For instance, in *Hawkes Bay Power*, Goddard J noted in her summary of why the cost of the work done was capital in nature:[84]

> The scale and degree of the work involved in the total project **and the money expended** on it leads to only one conclusion; that is, that the expenditure in question is capital in nature. [Emphasis added]

141. Accordingly, in the Commissioner's view cost alone is not a reliable indicator of the nature of expenditure. Sometimes costs can be high due to expensive parts or difficult, time-consuming work. But this alone does not necessarily change the nature of the work from involving revenue expenditure to capital expenditure. In some cases, replacing an asset might be cheaper than repairing it, but the fact the method chosen to resolve a repair issue is the cheapest (or, for that matter, the most expensive) "is neutral".[85] It does not change the character of the work done from being capital. However, as a general proposition, the Commissioner considers that the more significant the costs relative to the asset's value, the more likely the expenditure is capital in nature.[86]

Unsought benefits

142. In the *Auckland Gas* cases, inserting replacement gas pipes inside the old pipes meant the new pipes, although smaller, could carry gas at a higher pressure than the old ones. This increased the network's overall capacity. Although increased capacity was not a primary goal of the work because the system already had sufficient capacity for future growth, it was considered an improvement brought about by the work done that contributed to a change in the network's character.

143. This suggests that, if a result of work done to an asset is an unsought benefit, the fact this advantage was not the goal does not prevent a conclusion that the asset's character has changed.

82 At 15,708.

83 At 3,073.

84 At 13,707.

85 See *Auckland Gas* (PC) at 15,709.

86 See *Case N8* at 3,073.

Fine judgements are required

144. Analysing the nature and extent of the work done may call for careful judgement, especially when it comes to determining whether an asset's character has changed. This is illustrated by comparing the cases of *Western Suburbs Cinemas* and *Conn*.[87] Both cases involved significant work done to repair buildings, but the court in each case reached a different outcome.

145. The cost of replacing a theatre's ceiling with different materials was considered capital in nature in *Western Suburbs Cinemas*. In *Conn*, the court found the costs of extensive repair work to a 400-year-old protected building were deductible. The work included renewing roof timbers, replacing the slate roof with corrugated asbestos, removing some lower floor walls and adding steel supports and replacing the rotten timber ground floor with concrete. Buckley J considered the expenditure was deductible as it was incurred to put the building into a state of repair so it could continue to be used. He concluded:[88]

> [T]he result of this work was not to produce something new but to repair something which had previously existed. Upon that basis it seems to me that there is no ground for regarding this expenditure as a capital expenditure.

146. In *Conn*, the court found that, while the repairs improved the building, the work done did not go beyond repairs. The taxpayer aimed to maintain the building's utility without changing its size or location. The building was not completely reconstructed, replaced or renewed, nor was substantially the whole of the building reconstructed, replaced or renewed. In contrast, the ceiling work in *Western Suburbs Cinemas* went beyond repairs and changed the building's character.

147. Looked at together, the two cases illustrate the effect that the nature of the work done has on the assessment of an asset's character and whether it has changed. The cases also demonstrate the relevance of the particular materials used to answer this enquiry. The assessment of the work done is always a question of fact.

Key points on the nature and extent of the work done to the asset

148. The key points about the nature and extent of the work done are:

- When deciding whether the cost of the work done is capital in nature, consider the nature and extent of the work done to the asset.
- If the work done results in the reconstruction, replacement or renewal of the whole or substantially the whole of the asset, the cost of the work is capital expenditure.
- If the work done goes beyond repairs and changes the asset's character, the cost of the work is also capital expenditure.
- Determining the scale of the work includes consideration of the significance of the work done to the asset.
- When different materials are used in the work, consider whether they make the asset more useful or improve its performance or function. If so, this may show the asset's character has changed and the cost of the work done is capital expenditure.
- Changes to an asset's value, earning capacity, useful life, function or operating capacity—whether intended or not—cannot alone decide the nature of the work done to the asset has changed its character. Instead, courts sometimes use these factors to support an overall assessment of whether the asset's character has changed.

Examples 6–18: nature and extent of the work done to the asset

149. How to determine the nature and extent of the work done to the asset is illustrated in Example | Taurira 6 to Example | Taurira 18.

87 *Conn (HM Inspector of Taxes) v Robins Bros Ltd* (1966) 43 TC 266 (Ch).

88 At 274.

Example | Tauira 6 – Taxi driver replaces engine (no substantial reconstruction, replacement or renewal or change in character)

Frank is an owner-operator taxi driver and has been driving the same taxi for 5 years. The taxi has been dependable, is serviced regularly and is in good overall condition. However, Frank's mechanic recently told Frank the engine is now seriously worn and should be replaced. Frank arranges for his mechanic to replace the engine with a reconditioned engine that is comparable to the original engine.

The relevant asset is the taxi. The work does not result in a replacement, reconstruction or renewal of the whole or substantially the whole taxi. Also, the work done does not go beyond repairs to change the taxi's character.

The cost of the replacement engine and its installation is revenue in nature.

Example | Tauira 7 – Taxi driver upgrades engine (change in character)

Using the facts of Example | Tauira 6, instead of replacing the engine with a comparable one, Frank decides to upgrade to a more powerful engine so the taxi can tow a luggage trailer. The ability to carry extra luggage will expand his business.

The work upgrading to a more powerful engine goes beyond repairs and changes the taxi's character.

The cost of the replacement engine and its installation is capital expenditure.

Example | Tauira 8 – Refurbishment of item of manufacturing plant (substantial reconstruction, replacement or renewal)*

Best Processors Limited owns a large item of specialised plant that is central to its business. Despite regular maintenance, the company notices a decline in product quality due to wear and tear in various areas of the item. To maintain quality standards, the company decides to refurbish the item.

Extensive work is undertaken replacing key components in the item, including drive mechanisms, motors and the core processor unit.

As a result, production quality improves, although the plant's operating capacity stays nearly the same. The refurbishment cost is significant relative to the value of the plant.

The relevant asset is the item of manufacturing plant. The refurbishment has replaced key components of important and essential parts of the item.

Although the item's function and operating capacity is largely unchanged overall, a replacement, reconstruction or renewal of substantially the whole of the item has occurred. The nature, extent and scale of the work done supports the conclusion that the refurbishment costs Best Processors Limited incurred are capital in nature.

*This example is based on *Case N8*.

Example | Tauira 9 – Replacement of rotary platform in a dairy shed (substantial reconstruction, replacement or renewal)*

Loamsdown Farms needs to replace the rotary platform in its rotary dairy shed. The new platform will have the same capacity as the old platform. The existing platform's drive mechanism and motor will be kept.

The rotary platform and associated drive mechanism and motor is the relevant asset. Replacing the platform involves replacing and renewing substantially the whole of the asset. The platform is a significant and distinct part of the entire rotary platform system in terms of its size and value.

An increase in the platform's capacity is not necessary to show capital expenditure, if the replacement is so significant it amounts to the replacement or renewal of substantially the whole of the asset.

The cost of replacing the rotary platform is capital expenditure.

*This example is based on an example in IS0025: Dairy Farming – Deductibility of certain expenditure.[89]

89 IS0025: Dairy Farming – Deductibility of certain expenditure *Tax Information Bulletin* Vol 12, No 2 (February 2000): 10.

Example | Tauira 10 – Insulation top-up (no substantial reconstruction, replacement or renewal or change in character)

Pita and Aline own a residential rental property in Wellington. After a cold snap, their tenants complain the insulation is no longer effective. An inspection of the insulation confirms it has deteriorated and is no longer thermally efficient. Pita and Aline arrange for new insulation of the same standard as the old to be inserted into the house. Both the old and new insulation meet the requirements of the Healthy Homes insulation standards.*

The relevant asset is the house. The cost of the insulation is revenue in nature on the basis that it is a repair to the property and does not change the asset's character. It does not result in a replacement or renewal of substantially the whole of the house. The work done only restores the property to its former condition.

*See QB 20/01: *Can owners of existing residential rental properties claim deductions for costs incurred to meet Healthy Homes standards?*[90]

Example | Tauira 11 – New insulation (change in character)

Ravi and Priya own a residential rental property that has never been insulated. Their tenants have been asking for years for the walls and floors to be insulated. The Healthy Homes regulations have made a certain standard of insulation mandatory. Ravi and Priya have the required insulation installed.

The relevant asset is the house, and the cost of this new insulation is capital expenditure. It is not a repair to the rental property. The addition of insulation to the house improves the house and changes its character (see QB 20/01).[91]

Example | Tauira 12 – Replacement of garage roof using different materials (no substantial reconstruction, replacement or renewal or change in character)

Natalie and Albert own a large old residential rental property with a small attached lean-to garage. The cement-based corrugated roofing sheets of the garage have recently cracked and started leaking. The original roofing material is no longer available, so Natalie and Albert must use different materials to replace the garage's roof. To minimise costs, they use readily-available standard-sized corrugated steel roofing sheets that match the size of the old roofing. The sheets are pre-painted, so will require less maintenance.

The entire house, including the lean-to garage is the relevant asset. The work done does not result in a reconstruction, replacement or renewal of the whole or substantially the whole of the house. Also, the work done does not change the property's character. The use of the different material is not extensive and does not improve the rental property beyond restoring the garage's functionality. The cost of replacing the garage roof is revenue in nature.

90 QB 20/01 n 45 at [43].

91 At [42].

Example | Tauira 13 – Replacement of roof using superior materials (change in character)

Natalie and Albert own another rental property in the same neighbourhood that is of a similar age and size as that in the preceding example. This property has the same cracked and leaking cement-based roofing sheets as the other property, except in this case, it is over the entire roof of the house.

As in the previous example, Natalie and Albert have no option but to use different materials to replace the home's roof. In this case, because of the need to replace the roof over all the key living areas, they decide not to use the same roofing material as in the previous example. Instead, they choose to use a superior product that has a number of advantages. The product is less likely to leak compared to the standard sheets as it is a long-run roofing material with hidden fixings and standing seams. These features also give the house a more modern aesthetic. The roofing material is not only pre-painted but has a superior and more durable and longer-lived metal substrate and coatings, more suitable to the property's coastal location. It also has an absorbent layer on the underside to reduce condensation, enhance warmth and improve ventilation in the ceiling cavity.

The house is the relevant asset. The work done does not result in a reconstruction, replacement or renewal of the whole or substantially the whole of the house.

However, unlike the previous example, the work done has gone beyond the simple use of more modern equivalent materials to effect a repair. The roof has been replaced in its entirety and the choice has been made to use superior materials. The materials used provided significant advantages in terms of weathertightness, durability, appearance and maintenance. On balance, it is considered that the work done goes beyond restoring the roof's former condition by repair and the extensive use of superior materials changes the property's character.

The cost of the work undertaken is capital in nature.

Example | Tauira 14 – Replacement of roof using equivalent materials (no change in character)

Natalie and Albert own a third rental property in a different location. Over a number of years, the property has experienced ongoing issues with the roof leaking. They have been advised by their building contractor that the existing pre-painted steel roof has deteriorated to such an extent that further piecemeal repairs are unlikely to resolve the problem. As a result, they replace the roof in its entirety.

Unlike the previous examples, Natalie and Albert replace the roof using materials that are the equivalent of those used originally.

The house is the relevant asset. The work done does not result in a reconstruction, replacement or renewal of the whole or substantially the whole of the house. Nor does it go beyond the use of equivalent materials to effect a repair.

On balance, it is considered that the work done does not change the property's character. Accordingly, the cost of the work undertaken is revenue in nature.

Example | Tauira 15 – Major repairs to building (substantial reconstruction, replacement or renewal)

Minh owns a stand-alone single-storey commercial building, leased to a small manufacturing business. The building has severe leaks causing extensive damage to the wall claddings and untreated timber framing. To fix this, Minh undertakes extensive work on the building involving:

removing and replacing all the exterior wall cladding;

removing and relining portions of the interior walls;

replacing large sections of the wall framing with treated timber;

replacing damaged sections of the mezzanine office floor, including replacing sections of the floor joists with treated timber; and

installing new flashings around the windows.

The commercial building is the relevant asset. The cost of this work is capital expenditure because the work done is so extensive it has resulted in the reconstruction of substantially the whole of the building.

Example | Tauira 16 – Repair to land improvement (no substantial reconstruction, replacement or renewal or change of character)

Andrea owns a rental property built on a steep slope supported by a 40-metre long timber retaining wall. The wall is deteriorating at either end where it abuts adjoining properties. Approximately 2 metres of each end is repaired by replacing some lengths of the timber retaining. The relevant asset in this case is the retaining wall (a land improvement). The work done is not extensive enough to amount to a reconstruction, replacement or renewal of the whole or substantially the whole of the wall. The work done does not change the wall's character.

The expenditure on the work done to repair the retaining wall is revenue in nature.

Example | Tauira 17 – Kitchen renovations (no substantial reconstruction, replacement or renewal or change of character)

Emily and Charlotte have owned a residential rental property for several decades. Over the years the property has suffered tenant damage, particularly the kitchen which has had a couple of water leaks and a minor flooding incident. Minimal repairs have been made after each incident but, during a vacant period between tenancies, they decide to attend to this damage in a more comprehensive manner.

The kitchen bench and sink unit is removed to access and repair water damaged flooring and a new unit, bench and sink of the same dimensions and specifications are installed in the same location. The other joinery units are refurbished in situ by replacing the cupboard doors and repainting the unit carcasses. The floor covering, that had been badly stained in the flooding incident, is replaced. The ceiling and walls are repainted and the splashback replaced. The freestanding oven is replaced with a modern equivalent. The layout of the kitchen is unchanged and where items or materials have been replaced, they are generally replaced on a like-for-like basis.

In terms of the whole property, only a single room has been affected by the work, with no structural changes made. The extent of the work does not amount to the reconstruction, replacement, or renewal of the whole, or substantially the whole, of the rental property.

The layout of the kitchen has not been altered or improved and the work undertaken has not gone beyond restoring the original functionality of the kitchen. The nature and extent of the work have not gone beyond repairs to change the character of the property.

The cost of the work undertaken is revenue in nature.

Example | Tauira 18 – Kitchen renovations (change in character)

Mat and Harry purchased a tenanted, partially renovated rental property six years ago. With the long-term tenants now leaving, they see an opportunity to achieve premium rents by completing the renovations. The original kitchen is dated and worn, so they decide to fully renovate it.

The renovation involves partially removing a non-structural wall to create an open-plan kitchen and dining area. The kitchen is gutted, underfloor heating installed, and both rooms retiled. New kitchen joinery is fitted in a revised layout, requiring relocation of plumbing, waste, and hobs, along with rangehood ventilation adjustments. A new sink mixer, waste disposal, and filtered water system are added. The kitchen window is enlarged and replaced with double glazing and the dining window is retrofitted. Electrical upgrades include relocating oven supply, adding outlets, installing a high-capacity circuit for induction hobs, and adding task lighting. Both rooms are redecorated, and the property is re-let at a higher rent.

The relevant asset is the rental property. In terms of the whole property, only two rooms and a small portion of the roof have been affected by the work, with only a minor structural change to part of one internal wall. However, while the nature and extent of the work do not amount to a reconstruction, replacement, or renewal of the whole or substantially the whole of the rental property, it goes beyond repairs. The layout of key rooms has been enhanced, along with improvements to heating, thermal efficiency, quality of finishes, and the range of fittings. These upgrades have resulted in a change in the character of the asset, altering the nature and functionality of the affected parts of the property.

The cost of the work is capital in nature. Apart from the costs of any chattels treated separately for depreciation, the balance of the costs is added to the cost of the building and depreciated at zero percent.

Specific situations to consider under step 2

150. The courts have reviewed the deductibility of repairs and maintenance expenditure in various situations, and in doing so have highlighted specific situations that may affect the analysis of the nature and extent of the work carried out. This statement now considers whether the analysis or conclusions about the nature and extent of the work change if the work is:

- deferred and then completed all at once or spread out over many years;
- part of one overall project;
- for a recently acquired asset;
- the result of a significant event; or
- remedying an inherent defect.

Deferred repairs and protracted repairs

151. The timing of repairs varies among businesses. Some carry out regular repairs and maintenance, while others fix things only when necessary. Some may delay repairs and do them infrequently when convenient, while others may carry out regular maintenance with occasional major overhauls. Some repairs may be protracted and spread out over many years.

152. When major overhauls or repairs are deferred and done all at once, the nature and scale of work done can amount to entirely or substantially reconstructing, replacing or renewing the asset. The question of whether the work is capital expenditure due to its scale and irregular timing may arise.

153. Where the work done is the result of accumulated repairs, however, the expenditure may be deductible. The Privy Council's decision in *Rhodesia Railways* supports the view that deferring repairs should not change the character of those repairs from revenue to capital expenditure. Lord Macmillan stated:[92]

> The periodical renewal by sections of the rails and sleepers of a railway line as they wear out by use is in no sense a reconstruction of the whole railway and is an ordinary incident of railway administration. **The fact that the wear although continuous is not and cannot be made good annually does not render the work of renewal when it comes to be effected necessarily a capital charge**. [Emphasis added]

154. The same reasoning appears in obiter comments Rowlatt J made in *Ounsworth*.[93] In that case, a ship-building company incurred expenditure to regain access to the sea after a shipping channel silted up due to neglect. Rowlatt J held the costs were capital expenditure because the company had effectively abandoned its old means of access to the sea and constructed a new access.

155. However, both parties drew Rowlatt J's attention to the general capital or revenue test that suggests a once and for all payment is capital in contrast to expenditure that is recurrent. In the context of that test, Rowlatt J agreed that dredging costs that would be revenue expenditure if incurred annually, remain revenue in character if not incurred for a year or two and only incurred when "seriously required to get rid of a mischief which had been growing all the time".[94] The real test was whether the expenditure was to meet a continuous demand (in this case, the silting up of the shipping channel).

156. Some repairs may be such that they are spread out over many years and take a lengthy period to complete. Again, the courts have held that this timing matter alone does not decide whether the expenditure incurred is revenue or capital in nature. Lord Nicholls stated in the Privy Council's decision in *Auckland Gas* that:[95]

> The speed or slowness with which the work was carried out cannot affect its nature or, hence, its proper characterisation.

157. The costs of extensive work caused by deferred repairs can remain deductible provided the work remains in the nature of repairs. If, however, deferred or protracted repairs become so extensive, that they amount to the reconstruction, replacement or renewal of the whole or substantially the whole of the asset or alter the asset's character, the cost of that work is capital expenditure.[96] Also, if these repairs are part of one overall project that is capital in nature, then those repairs will take their character from the project.

92 At 1,039.

93 *Ounsworth (Surveyor of Taxes) v Vickers Ltd* [1915] 3 KB 267.

94 At 273.

95 At 15,708.

96 For example, compare and contrast, *Sherlaw v CIR* (1994) 16 NZTC 11,290 (HC) and *Case N8*.

158. When distinguishing between these different situations making an objective assessment of what the expenditure was "calculated to effect from a practical and business point of view" can be helpful.[97]

Work that is part of one overall capital project

159. When repair work is part of one overall project, the courts have indicated that the proper approach is to consider all the work carried out as a whole. It is not correct to separate out parts of the project for separate consideration.

Colonial Motor Co Ltd v CIR *(CA)*

160. In the *Colonial Motor Co Ltd* case, the Court of Appeal considered whether work converting a warehouse into an office building, including seismic strengthening, was a single project or whether the seismic strengthening could be considered separately.[98] The local city council deemed the building an earthquake risk and, without the strengthening work, it would need demolishing regardless of any other work that may have been undertaken to convert its use.

161. The work done involved constructing new concrete walls, removing a mezzanine floor, adding a penthouse, general refurbishment and seismic strengthening. The taxpayer categorised the expenditure into three groups: revenue, seismic strengthening and capital. The Commissioner and taxpayer agreed on the deductibility of the expenditure, except for the seismic strengthening costs. The taxpayer argued these costs were deductible as repairs and alterations that did not increase the capital value of the building in terms of the proviso to s 108 of the Income Tax Act 1976.

162. The Court of Appeal considered that, if there was one overall project, it must be assessed as a whole to decide whether it repaired or altered the asset. This was despite the dispute involving only the seismic strengthening costs, not the other costs already agreed on as either revenue (deductible) or capital (non-deductible). Looking at the total work carried out, and the size of the work involved, Richardson J found that the work did not involve two independent, unrelated projects. It was a single project that converted the eight-storey warehouse destined for demolition into a nine-storey office block. Richardson J stated:[99]

> The statutory inquiry is whether what was done comes within the description of "repairs or alterations of any such asset" ... . That statutory inquiry relates to the work that was actually done. If there was one overall construction project, it is the total work involved in relation to the particular premises which has to constitute "repairs or alterations of any such asset" so as to come within the proviso. In such a case it begs the question to say that the taxpayer could have confined itself to certain specific parts of the work done in which case that limited work would have constituted alterations. The allocation of the total expenditure to different categories of work does not change the character of the work that was done.
>
> **On the facts of this case it is essential to consider the total work carried out. It was not and could not sensibly have been the subject of two independent unrelated contractual projects, one for strengthening the building and the other for new and repair work. It was a single project** which converted the eight storey warehouse-type structure otherwise destined for demolition into a nine storey office block with a 50 year revenue earning life. ... The magnitude of the work involved is reflected in the total expenditure of $5.7 million of which the great bulk was in new work ($3.47 million) and the major part of the strengthening ($1.28m) was the construction of two new concrete walls. That was an entirely new structural addition.
>
> ... . While strengthening alone or capital and repairs alone might have added little if anything to the value, it was their combined effect that was so significant. [Emphasis added]

163. The Commissioner acknowledges that *Colonial Motor Co Ltd* addressed whether the work done was "repairs or alterations" under s 108 of the Income Tax Act 1976. However, in the Commissioner's view, the principle set out by Richardson J remains relevant when deciding the capital or revenue nature of expenditure incurred on work carried out as part of a larger project. Where repair work is part of one overall project to reconstruct, renew or replace the whole or substantially the whole of an asset or to change its character, the nature of the expenditure on the work is derived from the character of the entire project. The repair work is not looked at in isolation.

97 *Hallstroms* (HCA) at 648.

98 *Colonial Motor Co Ltd v CIR* (1994) 16 NZTC 11,361 (CA).

99 At 11,366.

Sherlaw v CIR *(HC)*

164. Whether there is a single overall project depends on the facts in each case. For example, *Colonial Motor Co Ltd* can be contrasted with *Sherlaw*. In *Sherlaw,* a boat-shed needed re-piling. The re-piling work caused the boat-shed's roof and floor to be substantially damaged. Consequently, the taxpayer replaced a large part of the roof that was unable to be repaired. Additionally, due to changes in the roof, the floor was raised slightly. The taxpayer used second-hand or salvaged materials from the original boat-shed for the repairs.

165. The Commissioner argued, based on *Auckland Trotting* (CA) and *Colonial Motor Co Ltd*, that the work on the boat-shed in *Sherlaw* was a reconstruction of substantially the whole of the boat-shed, making the costs capital in nature. Doogue J disagreed. He distinguished *Colonial Motor Co Ltd* because the building in that case was completely transformed and strengthened with a new layout and refurbishment. In contrast, the boat-shed retained its original size and layout with substantial parts remaining unchanged. There was no overall project to change the character of the boat-shed or to reconstruct, renew or replace it, substantially or in whole. Although the work was extensive, Doogue J attributed this to deferred maintenance rather than a decision by the taxpayer to reconstruct most of the premises.

166. In the Commissioner's view, *Sherlaw* highlights a situation where initial repair work led to additional work. While, in total, the repairs might be extensive, they were not undertaken as one overall plan to reconstruct, replace or renew the whole or substantially the whole of an asset or to change its character.

167. Doogue J also noted that the Commissioner did not classify any additional work beyond the original re-piling and floor work as capital work unless all of the work was treated as capital. He further stated that, if the Commissioner had argued that some part of the works was capital in nature, there may have been some point to the argument.[100] This suggests, as the work was not part of one overall project, different aspects of it could have been classified as either capital or revenue in nature, depending on their effect on the boat-shed.

Hawkes Bay Power Distribution Ltd v CIR *(HC)*

168. Goddard J considered *Colonial Motor Co Ltd* and *Sherlaw* in *Hawkes Bay Power*. In *Hawkes Bay Power,* the taxpayer argued that it did not have a single overall goal of replacing the overhead power system in its urban residential areas with an underground system. Instead, each replacement was done on a job-by-job basis according to the particular reason for the job. Goddard J disagreed, based on the documentary evidence and the taxpayer's acknowledged long-standing policy to convert those areas to an underground system. She found the work done to replace overhead wires with underground cables was part of an overall aim of replacing the entire overhead system in urban residential areas. Given the scale and degree of the work and its cost, she concluded the expenditure was capital in nature.[101]

169. Relying on *Sherlaw*, the taxpayer in *Hawkes Bay Power* had classified the costs into capital and non-capital items. For example, the cost of replacing worn-out overhead wires with underground cables was treated as revenue, while the costs of replacing distribution transformers was capitalised. On this point, Goddard J held:[102]

> In the context **of the total project** and the extent to which it has been achieved to date, **it is artificial to dissect the work into capital and revenue categories, or to further dissect the "purported" revenue category into capital and non-capital items.**
>
> As Kitto J said in *FC of T v Western Suburbs Cinemas Ltd* (1952) 86 CLR 102 at p 108:
>
> > "... the capital or income character of expenditure actually incurred depends upon the nature of the purpose for which it was incurred. **If a total expenditure is of a capital nature, so is every part of it**; you cannot take a portion of the work done such as the erection of a scaffolding and, closing your eyes to the purpose for which it was in fact erected, attribute to the cost of that portion an income nature for no better reason than that the same scaffolding, would have been erected in order to serve a purpose which, if it had existed, would have made the total expenditure an income charge." [Emphasis added]

170. *Hawkes Bay Power* clarifies that when work is part of a single overall capital project, it is artificial to dissect the work into capital or revenue categories. This is because all parts of the work done aim to achieve the same goal from a practical business point of view.

100 At [30].

101 At 13,707.

102 At 13,707.

Case 2/2020 *(TRA)*

171. In *Case 2/2020*, the taxpayer owned several properties, including a bar and an adjoining property used as the bar's parking lot.[103] In 2020, after the tenant vacated, the taxpayer spent over $680,000 on repairs and improvements to relet the bar. They claimed $408,000 as deductible repairs, but the Commissioner disallowed $332,000, deeming it capital expenditure.

172. The bar premises were in urgent need of repairs to be relet and reopened. The work including interior repainting and repairs to walls, floors and ceilings in the main room, bar, kitchen, office and storage. The exterior was repainted and repairs were made to the front sliding doors and rear roller doors. The bathroom floor and wall linings were replaced, and repairs were made to damaged light fixtures in the main room, office and behind the bar. Repairs were made to the kitchen wall linings, shelving and floors and to the gaming room carpets. Further repairs were made to door and window hardware.

173. The taxpayer also constructed a new toilet block and function rooms, added a veranda and fitted out a container. This work extended onto the adjacent property that had been used for parking.

174. The taxpayer argued the work on the bar and the adjoining property were separate projects. However, Sinclair J confirmed the Commissioner's view that it was one overall capital project. She considered the following:

- The physical object of the work was the existing building on the bar property that included the external areas and amenities that extended onto the adjoining property.
- It was clear from the evidence, including the engineer's report and various plans and drawings attached to the approved building consents, that the work undertaken on the building and extension was substantial. This was also reflected in the total expenditure incurred.
- The work was undertaken as one overall project:
  - The taxpayer did not complete a repair of the bar property and then later decide to extend the property onto the adjoining property. Rather, work under the building consents was carried out on both properties and it was clear on a review of the council's inspection records that this work was going on at the same time.
  - The expenditure on the work on each property was not accounted for separately. Rather, the expenditure was recorded under the bar property in the taxpayer's accounts.
  - There was no "disjoint" between the work done on the bar property due to its past use for rental purposes and that done on the adjoining property to increase the taxpayer's rental revenue. The work done on the bar property and on the adjoining property could not have been the subject of two independent, unrelated projects. Rather it was a single project that extensively refurbished and modernised the building and enclosed many of the outdoor spaces.
  - The character of the entire project of work was capital in nature. Therefore, the character of the disputed expenditure was also capital in nature and non-deductible for income tax purposes by the taxpayer.

175. Overall, the works extended and modernised the bar building. While the core building remained, the extension built on the adjoining property increased the size of the building to include the covered veranda and other spaces detailed in the building consents. The works resulted in an increase in the building's floor area, the creation of new function rooms and an increase in the maximum occupancy thereby generating the opportunity to increase the rental income the taxpayer could earn from the bar building.

176. The work the taxpayer did went beyond repairs and replacement. The nature and extent of the work done to the building clearly demonstrated that the works undertaken renewed and/or substantially reconstructed and improved the original premises, thereby changing the building's character.

177. It followed that the cost of the total work could not be apportioned into deductible revenue costs and capital costs that could be treated separately.

103 *Case 2/2020* [2020] NZTRA 2.

Case 3/2025 *(TCRA)*

178. In *Case 3/2025*, the costs of certain works concerning earthquake strengthening and the glass façade of a commercial building could not be treated separately from other works carried out on the building.[104] This was despite the work being the subject of separate contracts. The Taxation and Charities Review Authority did not consider the contractual arrangements as important in characterising the work as repairs or capital work.[105]

179. The authority concluded that the costs of the disputed works were capital in nature because:

- they were an integral part of a major capital project; and
- if considered by themselves, they went beyond the scope of repair, altering the character of the building.

180. The authority also noted that the use of better materials in the strengthening and reglazing had resulted in some improvements, but considered this was not a factor affecting its analysis. The authority considered it is the reality and extent of improvement and the amount of the work required that is most relevant.[106]

Separate treatment of costs possible in some situations

181. When there is a single overall capital project it is important to define its scope. Some work done at the same time may be outside the project's scope. If it can be shown that certain work done is not part of the project, it may be treated separately. The nature of this work must be decided on its own facts. If it does not reconstruct, renew or replace the whole or substantially the whole of an asset or change the asset's character, the expenditure on that work is likely to be revenue in nature and deductible.

182. Accordingly, repair work done at the same time as a capital project is not automatically part of the project just because of the timing of the work. Separate treatment may be possible provided the work is truly repairs and can be distinguished from the project work. This is more likely to be the case if the repair work was separately organised, contracted and paid for.

183. In *Poverty Bay Electric Power Board* (CA), Blanchard J recognised that separate treatment of costs is possible and appropriate in some, but not all, situations. Blanchard J stated:[107]

> In particular situations an apportionment of an amount of expenditure is possible and appropriate — where a part of the money spent has been applied to work which is truly a repair and at the same time some upgrading of a capital nature has been done. It is often possible to distinguish which is which. But this is not such a case. Completely new sections of line were installed. There was no repairing of the old overground system or re-use of existing materials. The old lines were simply removed and, presumably, scrapped.

184. As Blanchard J's comments suggest, separate treatment may include the situation where apportionment of amounts of expenditure is required. This may be necessary where the same contractor undertakes both the maintenance and the capital project (see Example | Tauira 23 at [208]).

185. To determine whether apportionment is appropriate, it is necessary to consider the work done from a practical business point of view. For example, in the Commissioner's view, apportionment of expenditure between capital and revenue is appropriate where the work done is a repair, but at the same time some upgrading of a capital nature can be identified (*Sherlaw*). In contrast, where repairs and maintenance work forms part of one overall project, where the objective of that project is to reconstruct, replace or renew the whole or substantially the whole of the asset or to change the asset's character, then apportionment is not appropriate and all expenditure incurred as part of that project takes its nature from the overall project (*Colonial Motor Co Ltd*, *Hawkes Bay Power* and *Case X26*).

Work that is essential to make a recently acquired capital asset suitable for its intended long-term use

186. Sometimes, the cost of repairs may be considered part of the capital cost of acquiring an asset ("initial repairs"). Initial repairs are repairs a taxpayer carries out on a capital asset they have recently acquired where the expenditure is non-deductible capital expenditure.

104 Case 3/2025 [2025] NZTCRA 3. **Note:** At the time of publication, an appeal of this decision is pending.
105 At [60].
106 At [69]–[71].
107 At 15,008.

187. Broadly, initial repairs involve work on the capital asset essential to make it suitable for the acquiring taxpayer's intended long-term use. The expenditure is non-deductible even though, given the nature and extent of the repair work, the expenditure would have been of a revenue nature and a deductible expense if the previous owner of the asset had incurred it (assuming the general permission was met).

188. For more information on initial repairs, including examples, refer to QB 25/17: *Income tax: Can I claim a deduction for expenses I incur on repairing a recently acquired capital asset?*[108]

Significant events

189. As mentioned at [47], the need or occasion for the expenditure is one of the factors arising under the general capital or revenue tests and, in a repairs and maintenance context, this requires focusing on why the work was done in a particular manner. In that context, the courts tend to focus more on the effect of the work, rather than its timing or cause.

190. The Commissioner considers that the nature of repairs and maintenance expenditure remains the same, regardless of whether the damage to be repaired was caused by regular wear and tear or a significant event such as an earthquake, fire or a storm. Therefore, the same considerations set out in this statement apply to decide whether the expenditure is capital or revenue expenditure.

191. In *Case F67*, a commercial building with two shops, was extensively damaged by fire. The taxpayers claimed a deduction for the portion of the costs of making the building good after the fire that the insurance payment did not cover. The Commissioner disallowed the deduction on the basis it was capital expenditure. Judge Barber identified the building, not the individual shops, as the relevant asset and concluded that the work undertaken was so extensive it amounted to the replacement, reconstruction or renewal of a substantial part of a capital asset that went beyond the normal concept of repair. He concluded that as the taxpayers' expenditure was not to repair the building but to rebuild it, it was capital and not deductible. The fact the cause of the work was a significant event did not alter the two-step approach to applying the capital limitation.

192. In the Commissioner's view, if work done due to a significant event leads to the reconstruction, replacement or renewal of the whole or substantially the whole of the asset or the asset's character changes, the expenditure is capital in nature.

193. As mentioned from [151], deferring repairs does not of itself change the character of the expenditure on deductible repairs, even if the work is more extensive due to the delay. This applies even if the deferred repairs are prompted by a significant event.

194. The Tax Court of Canada case of *Martinello* illustrates this.[109] In *Martinello*, the taxpayer's residential rental property was significantly damaged by a storm, making it uninhabitable. Other than painting and cleaning the property had received no maintenance for eight years before the storm and dampness over the years had weakened the floor structure, leading to much of the damage caused by the storm. The property had other tenant wear and tear and damage that was repaired at the same time as the storm damage was repaired.

195. The house was restored to its original rentable condition. The court found that all the repairs were the result of tenant or storm damage and did not improve the house beyond its original condition. The court described it as a "somewhat run-down looking old house" before the work and "a patched up and somewhat run-down looking old house" after the work that could not be rented out at any more than previously.[110]

196. Although undertaken all at once, the costs were not capital in nature. The Commissioner considers the court reached this conclusion because, while the work the taxpayer undertook was extensive, the storm damage was largely due to deferred repairs. Implicit in this is that the court in *Martinello* considered the work done by the taxpayer did not reconstruct, replace or renew the house, or substantially the whole of the house or change its character.

108 QB 25/17: Income tax: Can I claim a deduction for expenses I incur on repairing a recently acquired capital asset? *Tax Information Bulletin* Vol 37, No 7 (August 2025): 61.

109 *Martinello v R* 2010 TCC 432.

110 At [15].

Inherent defects and leaky buildings

197. Inherent defects are faults in an asset's design, construction or manufacture that can subsequently cause a need for work to be carried out on the asset. This may be because the defect requires routine maintenance and repair work to be brought forward or because it results in additional required work, or both. In New Zealand, an example of inherent defects in a repairs and maintenance context involves properties that have been referred to as "leaky buildings" or "leaky homes".[111]

198. As noted at [105], the courts have considered a "repair" involves the restoration of a thing to a condition it formerly had without changing its character. In the case of leaky buildings, this raises the question of what is the asset's relevant former condition. In the Commissioner's view, this is likely to be the "as constructed" condition of the building, including the inherent defects in that construction. Therefore, work to remediate damage caused by the inherent defects that goes beyond restoring this original condition may not involve repairs if the building is improved or enhanced by removing the inherent defects. In that case, the nature of the work undertaken is more likely to be considered an improvement, the costs of which involve capital expenditure.

199. With leaky buildings an improvement is highly likely to occur. The removal of the inherent defect is likely to be a legal requirement imposed on work done to remediate damage in a leaky building, so it meets current building standards. It is also likely the work required involves replacing original materials used in constructing significant and integral parts of the building with superior materials.

200. While the presence and removal of an inherent defect is a relevant factor, it is not solely determinative. Caution is needed when focusing on the original cause of the work because it can "significantly distort the analysis of whether work is repair, or more major focusing".[112] As explained at [85], the second step in deciding whether the capital limitation applies, involves considering the nature and extent of the work carried out on the physical asset. And, as mentioned at [189], the courts tend to focus more on the effect of the work, rather than its timing or cause.

201. However, resolving weathertightness issues in buildings often requires extensive remediation work. As mentioned, it is also likely to involve work on significant and integral parts of the building, meaning the extent of the work is more likely to involve expenditure that is capital in nature.[113] Even, if the extent of the work does not result in the reconstruction, replacement or renewal of the whole or substantially the whole of the asset, the nature of the work is likely to change its character. Especially, given the effect of making a building weathertight is usually a significant change in its original condition and its functionality.[114]

202. In this regard, whether work is required because of regulatory requirements does not determine whether it is on revenue or capital account.[115] And, nor does the fact the materials required to be used produce an unsought benefit (see [142]).

203. The income tax treatment of expenditure incurred to remediate weathertightness issues with these types of properties has been considered by the High Court in *Lawrence* and by the Taxation and Charities Review Authority in *Case 4/2025*.[116] In both cases, the expenditure was found to be capital in nature.

204. In *Lawrence*, while faults in the roof design contributed to the damage, the court determined the treatment of the expenditure based on the nature and scale of the work carried out. Andrew J stated:

> 113. … In this case, the scale of the remediation works was significant. The work done affected nearly every part of the property. This included the roof, gutters, cladding, windows, timber framing, decks, retaining and surrounding drainage. As noted, the work also addressed design issues and replaced damaged materials.

111 Primarily involving houses and apartments built in New Zealand since the mid-1990s that have weathertightness issues. See **Leaky homes** (webpage, New Zealand Government, last updated 28 September 2020, govt.nz/browse/housing-and-property/leaky-homes).

112 *Case 4/2025* [2025] NZTCRA 4 at [81].

113 See *Lawrence* at [113] referencing *Western Suburbs Cinemas* at 106 and *Case L68* (1989) 11 NZTC 1,398 (TRA).

114 See also *The Leaky Building Crisis – Understanding the Issues* (Thomson Reuters, Wellington, 2011), Chapter 12 Tax Law Issues at 12.2.2(2)(b) per Craig Elliffe.

115 See *Case X26* at [48].

116 *Case 4/2025*, above n 112.

205. In *Case 4/2025*, the authority considered work to remediate a leaky apartment was substantial including in terms of its cost, its effect in improving a critical component of the building (exterior cladding) and the restoration of structural framing.[117] This is despite the authority acknowledging the smaller scale of the work involved compared with that in *Lawrence*.[118]

206. In summary, the Commissioner's view is that it is not the cause of the work (ie, an inherent defect) or the fact of its removal that, of itself, means the asset's character is changed. Although this factor is relevant, it is not determinative of whether the work is capital in nature. In the case of leaky buildings, however, the nature and extent of the work that is likely to be needed to remediate weathertightness issues caused by inherent defects are likely to mean those defects must be removed. And, in so doing, significant and integral parts of the building may be affected in a manner that inevitably requires substantial work. This work is likely to go beyond a repair and change the character of the building (compared with its original defective character). This means it is more likely than not that expenditure on remediating a leaky building will involve capital expenditure, unless the nature and extent of the work is limited (see Example | Tauira 26 and Example | Tauira 27 at [208]).

Key points about the specific situations

207. The key points about the specific situations to consider under step 2 are:

- The timing of repairs and maintenance work is not a critical factor when deciding whether the costs are deductible. Such work can be deferred or protracted and completed as and when needed without the costs necessarily becoming capital in nature. The deductibility of such costs is decided more by the nature of the work carried out and its effect on the asset, rather than on when the work is done.
- Repairs and maintenance work that is part of a single overall capital project to reconstruct, replace or renew the whole or substantially the whole of an asset or to change that asset's character takes its nature from that project.
- Where there is a single overall capital project, costs of repairs and maintenance work that are not part of the project can be treated separately.
- Where repairs and maintenance expenditure is incurred on an ad hoc basis and not as part of one overall plan, the expenditure should take its character from the effect the work done has on the asset.
- Repair cost on a recently acquired asset to make it suitable for the taxpayer's intended long-term use is a capital cost and forms part of the asset's acquisition cost. If the asset is used to earn income before the intended repairs are completed, any additional repairs caused by this use may be deductible.
- Some causes of repair work may not be particularly influential in determining the nature of the relevant expenditure. These include where an asset is damaged by a significant event (eg, a fire, earthquake or storm). Whether repairs and maintenance expenditure is deductible depends on the nature and extent of the work undertaken, not on the event that caused the damage.
- Where an asset is damaged due to an inherent defect, the cause of the work and the removal of the defect are relevant, but not solely determinative. In the case of leaky buildings, the nature and extent of the work typically required to address weathertightness issues often necessitates the defect's removal. This process frequently affects significant and integral parts of the building, resulting in substantial work. Such work is likely to go beyond a repair and change the character of the building from its original, defective condition. Accordingly, unless the work is limited in its nature and extent, the expenditure is more likely to be characterised as capital in nature and not deductible.

Examples 19–27: specific situations

208. Specific situations are illustrated in Example | Tauira 19 to Example | Tauira 27.

117 At [86].

118 At [109].

Example | Tauira 19 – Repairs to rental property (deferred repairs)

Hasan owns a rental property that has not been repaired in a long time. Recently, after the tenants moved out, Hasan decided to restore the property to a good condition before renting it out again. Hasan incurs significant expenditure (relative to the value of the property) on undertaking work that includes:

- extensive cleaning and repainting;
- fixing windows so they open and shut smoothly and replacing cracked panes;
- sanding and re-varnishing the floors;
- replacing the kitchen bench top;
- fitting a new hand basin to replace a cracked one; and
- having a plumber check and repair all the taps.

The rental property is the relevant asset. Hasan has not replaced, reconstructed or renewed the whole or substantially the whole of the property. The work does not change the property's character. Even though Hasan has incurred significant costs, they arose from repairs that had been allowed to accumulate.

The expenditure Hasan incurred is considered revenue in nature.

Example | Tauira 20 – Building refurbishment and strengthening project (one overall project)

Lot Developments Limited has owned an old commercial building for 10 years. The building looks rundown, and the local authority requires the company to have earthquake-strengthening work carried out. The company decides to undertake work to completely refurbish the building at the same time. This work includes:

- making structural changes to extend the floor plan;
- enhancing shared areas; and
- completing the required earthquake-strengthening.

The commercial building is the relevant asset. The work undertaken involves the reconstruction of the building or a substantial part of it or otherwise alters the character of the building. All the expenditure incurred is capital expenditure as it forms part of one overall capital project. No deduction is allowed for the cost of any repairs included in the project, the costs of which may otherwise have been deductible.

Example | Tauira 21 – Repairs to building (no overall project)*

Northern Roasters Limited decides to repair the wooden floor of its small factory that had become worn and uneven. After removing some floorboards, it became apparent that the floor's unevenness was due to ground subsidence. Repairing the effects of this involved minor foundation work. Accessing the foundations involved removing some of the floor's subframe that then needed to be replaced. However, this work, in turn, caused cracks in several windows and walls, which then had to be repaired, re-plastered and painted.

The factory premises are the relevant asset. Although the repairs were costly, they were done on an ad hoc basis and not part of an overall plan to reconstruct, replace or renew the whole or substantially the whole of the premises. The repairs did not change the character of the premises.

The repairs and maintenance expenditure is considered revenue in nature.

*This example is based on *Sherlaw*.

Example | Tauira 22 – Double glazing (one overall project—no apportionment)

Mei owns an old villa used solely for her restaurant business. To cut heating costs and reduce noise levels inside the restaurant from a busy road, she decides to install double glazing throughout the entire villa. During installation, the builder finds two instances of rotten window framing on the villa's south side and repairs them to allow for the double glazing.

The villa is the relevant asset. Mei's goal was to install double glazing, which has changed the villa's character. The window repairs were part of this project. Therefore, all the expenditure Mei incurred, including the cost of repairing the window framing, is capital in nature. It is not a situation where apportionment arises.

Example | Tauira 23 – House painting and extension project (one overall project—apportionment)

Jorge owns a rental property and decides to add two new bedrooms and another bathroom to increase the rental returns. He hires a builder to build the new extension and a painter to repaint the entire property and new extension.

The rental property is the relevant asset. Jorge's goal was to extend the house, changing its character. The cost of the extension is of a capital nature. Painting the new extension is part of this project and is also capital in nature.

However, re-painting the rest of the house is maintenance work even though it is undertaken at the same time as the capital improvements. It is possible to distinguish it from the scope of the project to extend the building. Therefore, Jorge can treat the portion of the painting expenditure that relates to painting the rest of the house as revenue in nature.

Example | Tauira 24 – Repairs of rundown commercial building (significant event)

David and Angus own a commercial building that was superficially damaged in an earthquake. They have owned the property for a long time. It was in excellent condition when it was purchased but over time, in the absence of routine maintenance, it has become rundown. The building's poor condition means more repairs are needed following the earthquake than would have otherwise been needed. David and Angus spend money on the building:

- the interior walls are re-plastered and repainted;
- the stairwells are repaired;
- the roof is repaired;
- cracked and broken windows are replaced, and
- the exterior walls are repainted.

The commercial building is the relevant asset.

The work done restores the building's functionality but does not reconstruct, replace or renew the whole or substantially the whole of the building. The work also does not change the building's character. The expenditure David and Angus incurred is for accumulated repairs and is revenue in nature.

Example | Tauira 25 – Reconstruction of damaged rental property (significant event)

Heni and Peter own a residential rental property that is significantly damaged in an earthquake. To make it tenantable again, they:

- replace the severely damaged foundations;
- reconstruct the floors;
- rebuild three collapsed external walls;
- replace the severely damaged roof; and
- demolish the partially collapsed chimney, which was a hazard.

The rental property is the relevant asset. The cost of this work is considered capital in nature and is not deductible. This is because the work is so extensive that it results in the reconstruction, replacement or renewal of the whole or substantially the whole of the asset.

Example | Tauira 26 – Repairs to residential rental property (leaky building - no substantial reconstruction, replacement or renewal or change in character)

Cath and Simon own a residential rental property. A few years ago, they added a three-room extension to the property. Recently, they noticed a small part of the extension's southern wall has been leaking due to a poorly designed and installed window flashing used in its construction. Some of the untreated timber framing under the window is rotten and needs replacing with treated timber. To fix the wall, some of the external cladding and the window must be removed and refitted. A redesigned window flashing is correctly fitted when the window is reinstalled.

The relevant asset is the house. The extent of the work done to the house does not amount to a reconstruction, replacement or renewal of the whole or substantially the whole of the house. Also, it does not change the house's character. This is true despite the nature of the work involving removing an inherent defect in the extension's construction and the limited use of improved materials (ie, the treated timber framing and redesigned window flashing). These aspects of the nature of the work alone do not necessarily mean the character of the house has changed. Whether the work carried out is sufficient or extensive enough as to change the house's character is a question of degree.

The limited nature and extent of the work carried out is such that the cost of the work undertaken is not capital in nature and the expenditure is deductible.

Example | Tauira 27 – Repairs to residential rental property (leaky building – change in character)

Cath and Simon (from Example | Tauira 26) recently discovered one of their other rental properties has major weathertightness issues. The property has design features and construction faults commonly associated with a "leaky building". Investigations show the repairs needed are extensive. The exterior cladding was directly fitted to the untreated structural timber framing, as was the established building practice at the time of the property's construction. This design combined with inadequate sealing of the cladding joins has allowed water to reach the timber framing in the most exposed external walls and in some ceilings abutting these walls, causing the framing to rot. Water has also damaged the interior wall and ceiling linings in the affected areas.

Remediating the weathertightness issues requires replacement of the rotten timber framing with treated timber and replacing the cladding with a current code compliant cladding that features an air gap to help prevent similar weathertightness issues recurring. Relining of the interior wall and ceilings and repainting of the interior and exterior are also necessary.

The rental property is the relevant asset.

The extent of the work done may not amount to a reconstruction, replacement or renewal of the whole or substantially the whole of the house, however, it goes beyond repairing it to its original condition. It requires substantial work and use of a superior exterior cladding system and timber framing. Overall, the nature, scale and extent of the work carried out, is sufficient to change the house's character.

The cost of the work undertaken is capital expenditure.

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Appendix: Additional case law – step 1: identify the asset being worked on

***Lindsay v FCT* (HCA)**

209. As mentioned at [67], in *Lindsay* (HCA),[119] Kitto J considered the enquiry into whether something was "a physical thing which satisfies a particular notion" included considering whether it was:

- an "entirety by itself" and not a "subsidiary part of something else"; and
- separately identifiable as a principal item of capital equipment.

210. The first factor suggests the slipway that was the focus of the case was whole or complete in itself, rather than being a part of a larger aggregation of things forming an asset. The second factor, though less clear, suggests the slipway was important enough to be considered an asset in its own right. It could be distinguished from other items possibly because it was a functioning unit in its own right or had unique physical characteristics, such as not being physically attached to other items or having physical characteristics that differ from those of other items. *Lindsay* was appealed to the full bench of the High Court which agreed with Kitto J's decision.[120]

***Auckland Gas Co Ltd v CIR* (PC)**

211. In *Auckland Gas* (PC) the taxpayer faced significant issues with its low-pressure gas-distribution system due to leaking, corroded and fractured pipes.[121] By the 1980s, the system was in poor condition and costly to maintain. To fix this, the taxpayer inserted polyethylene piping into the old pipes, allowing for higher pressures and reduced leaks. The old pipes acted only as a support for the new pipes.

212. The Privy Council identified the object to which the test of repair or replacement was to be applied was the gas distribution system being "an assemblage of linked pipes whose function was to carry gas from one place to another".[122] This suggests having a degree of physical connection between component parts is relevant to identifying the relevant single asset. It is also essential to consider the asset's function and the components necessary to carry out that function.

***Poverty Bay Electric Power Board v CIR* (CA)**

213. In the case of *Poverty Bay Electric Power Board*, the Court of Appeal reviewed the costs of replacing overhead electricity lines with underground cables.[123] The court agreed with the High Court that the relevant asset was the Gisborne urban power reticulation system, not the wider Poverty Bay system.[124] However, the Court of Appeal disagreed with the High Court's view that each separate section of the line could also be viewed as a separate asset. This was because each section was part of an integrated system and incapable of separate operation. This suggests that for the entirety test, it is important to consider whether something can function on its own. That is, it includes all the parts that are necessary for it to function. It is also relevant whether something is a component part of an "integrated system" rather than a separate asset.

214. The Court of Appeal concluded that the relevant asset was the Gisborne urban system because it was clearly distinguishable in engineering terms from the rest of the Poverty Bay system, in that "[i]t could be switched (or isolated by electrical means) from the rest of the Poverty Bay network".[125]

119 *Lindsay v FCT* (1961) 106 CLR 377 (HCA).

120 *Lindsay v FCT* (1961) 12 ATD 505 (HCA) (full bench).

121 *Auckland Gas Co Ltd v CIR* (2000) 19 NZTC 15,702 (PC). **NOTE:** Effective from 1 April 2008, a gas and electricity network, like those involved in *Auckland Gas, Poverty Bay Electric Power Board* and *Hawkes Bay Power*, are likely to be treated under the Act as a "utilities distribution network" made up of "utilities distribution assets". For tax purposes, the components, rather than the entire network, are treated as the relevant asset for depreciation (s EE 6(2B)) and for repairs and maintenance (s DB 68).

122 At 15,707.

123 *Poverty Bay Electric Power Board v CIR* (1999) 19 NZTC 15,001 (CA).

124 *Poverty Bay Electric Power Board v CIR* (1998) 18 NZTC 13,779 (HC).

125 At 15,007.

***Hawkes Bay Power Distribution Ltd v CIR* (HC)**

215. In *Hawkes Bay Power*, the High Court reviewed the costs of replacing overhead electricity lines with underground cables.[126] Using the analysis from *Lindsay* (HCA), Goddard J decided the urban residential distribution system was the relevant asset because it was:[127]

- a physical thing that satisfied a particular notion;
- an entirety by itself and not a subsidiary part of anything else; and
- a separately identified principal item of capital equipment.

216. The urban residential distribution system was the network of transformers and distributors that supplied electricity to domestic consumers in a specific area. This suggests the focus is on a physical thing (ie, the electricity network) that carries out a particular function (ie, the supply of electricity). The urban residential distribution system was found to be the relevant asset and not part of a larger distribution system because it was physically capable of being separately and independently installed underground without recourse to or having any effect on the other areas the distribution system satisfied.[128]

217. This was so, despite the urban residential distribution system: [129]

- could not operate as an independent entity (if disconnected from the national grid); and
- was not an entire profit-earning structure.

218. It is clear from this that in defining an asset it is not necessary that everything needed to earn a profit from the asset is included.

219. Goddard J noted that the urban residential distribution system was identified separately by customer type and area, with its separateness further highlighted by the fact most of it was underground. The customer area and type distinguished "urban residential" from "urban industrial" and "rural" customers. Goddard J seemed to focus on physical factors, such as location, when deciding whether two items were separately identifiable.

220. Goddard J considered the distribution system was a principal item of capital equipment in itself due to the significant cost involved in putting the network underground, the comparative cost with overhead lines, and the extent of the system that had been put underground. This led "to the irrefutable conclusion" that the system was "a principal item of capital equipment".[130]

221. Goddard J also found that the distribution transformers replaced during the undergrounding work were a part of the distribution system. This was because they were an integral part of the distribution system necessary for it to perform its function of supplying electricity. This suggests items that are integral to an asset's ability to fulfil its physical function tend to be a subsidiary part of the asset.

***Case F67* (TRA)**

222. In *Case F67*, Judge Barber considered a rental property divided into two shops was a single item of property despite this division because the property functioned as one set of premises in terms of title, ownership, insurance and administration of the tenancies.[131] The fact the building was internally partitioned did not change Judge Barber's finding that the building as a whole was the relevant asset.

126 *Hawkes Bay Power Distribution Ltd v CIR* (1998) 18 NZTC 13,685 (HC).
127 At 13,701.
128 At 13,701.
129 At 13,701.
130 At 13,701.
131 *Case F67* (1983) 6 NZTC 59,897 (TRA).

***Case N8* (TRA)**

223. In *Case N8,* the taxpayer was a substantial manufacturer and supplier of ready-mixed concrete.[132] The case concerned substantial works undertaken to a ready-mixed concrete "batching plant". The taxpayer argued the entire batching plant, including the ground storage bins, conveyor, tower, water and electrical equipment, dispatch office, control room and dispatch facilities, should be considered one entity. The taxpayer claimed the relevant expenditure was for repairs or maintenance of this asset. The batching plant was located on a large property with several buildings and facilities including an office, laboratory, control and supervisor's office, yards, truck parking and washing area, and storage yards.

224. The Commissioner disagreed, stating each part of the batching plant should be separately considered to see whether there had been a repair, renewal or replacement.

225. After thoroughly reviewing the nature of the taxpayer's business and the assorted items of expenditure, Judge Bathgate considered which asset or entity should be used to evaluate the nature of the expenditure, noting:[133]

> **I find there were two entities involved in the work.** The first and obvious is that which stores, conveys, mixes and produces the materials making up and contained in the final ready mixed concrete as supplied by the objector. **That entity is physically attached or joined**, or so far as the materials are concerned, **it is continuously involved in the one process** of manufacturing ready mixed concrete. To identify any one part and single it out for separate treatment as an individual item would be unrealistic in this context. **It is a composite whole**. If a motor car has a new spark plug installed in the place of an existing spark plug, so far as the motorist is concerned that is work undertaken in the course of repair or maintenance of the motor car, and is not a renewal of the spark plug as a capital item. **It is a question of fact, degree and impression as to what is included or excluded in an entity for present purposes**. The entity in the example given is the motor car. If the gearbox was replaced, that may be a repair, but if the engine were replaced, that would seem more like a capital item.
>
> **I consider the supervisor's office, the dispatch office and the control room, which were all housed in a separate and detached building from the ground bins, elevators and tower, to be a separate and distinct entity from the ground bins, elevators and tower plus its contents.** The only connection between the two were the electrical wiring connections and the less tangible connections of electrical controls, administration and supervision from one to the other. [Emphasis added]

226. Judge Bathgate identified two separate entities as being the relevant assets. The first entity included the components attached to each other that stored, conveyed, mixed and produced the materials for the ready-mixed concrete. The second entity consisted of the separately housed control room and the dispatch and supervisor's offices. Despite being connected, Judge Bathgate emphasised that these two entities were physically and functionally distinct from each other:[134]

> Different functions, although associated functions, were carried out in the two entities. The first was the entity handling the raw materials that were manufactured into ready mixed concrete. The second was more in the nature of an administrative office which controlled and supervised the functions of the first entity.

***O'Grady (HM Inspector of Taxes) v Bullcroft Main Collieries Ltd* (KB)**

227. In *O'Grady,* the taxpayer built a replacement chimney stack to carry away smoke and fumes from furnaces used to create steam power for the taxpayer's factory, just as the old unsafe chimney had done.[135] Rowlatt J found the chimney stack, not the factory, to be the relevant asset. Therefore, the expenditure on the replacement chimney was considered capital in nature. Rowlatt J (referring to *Lurcott*[136]) said:[137]

132 *Case N8* (1991) 13 NZTC 3,052 (TRA).
133 At 3,070.
134 At 3,071.
135 *O'Grady (HM Inspector of Taxes) v Bullcroft Main Collieries Ltd* (1932) 17 TC 93 (KB).
136 *Lurcott v Wakely and Wheeler* [1911] 1 KB 905.
137 At 101–102.

> As regards the chimney, I think it is really very clear. Of course every repair is a replacement. You repair a roof by putting on new slates instead of old ones, which you throw away. There is no doubt about that. But the critical matter is … **what is the entirety**? The slate is not the entirety in the roof. You are repairing the roof by putting in new slates. What is the entirety? If you replace in entirety, it is having a new one and it is not repairing an old one. **I think it is very largely a question of degree**. … This was a factory chimney to which the gases and fumes, and so on, were led by flues and then went up the chimney. It was unsafe and would not do any more. What they did was simply this: **They built a new chimney at a little distance away in another place; they put flues to that chimney and then, when it was finished, they switched the gases from the old flues into the new flues and so up the new chimney**. **I do not think it is possible to regard that as repairing a subsidiary part of the factory**. I think it is simply having a new one. And they had them both. Perhaps they pulled down the old one; perhaps they kept it, because they thought it was an artistic thing to look at. There is no accounting for tastes in manufacturing circles. Anyhow, they simply built a new chimney and started to use that one instead of the old one. I think the chimney is the entirety here and they simply renewed it. [Emphasis added]

228. Rowlatt J determined the chimney was not a subsidiary part of the factory. He noted the chimney was built a little distance away at another location, which might suggest that its physical separation from the rest of the factory influenced his decision.

***Samuel Jones & Co (Devondale) Ltd v IRC* (IH (1 Div))**

229. The later decision of *Samuel Jones* also concerned the replacement of a chimney stack.[138] The taxpayer used a steam plant (with a chimney) to power their paper-processing factory. The chimney was in a dangerous condition and was replaced by a new one. The new chimney was built near the old one, which was demolished once the new chimney was operational. Both chimneys were part of the main factory block's structure.

230. The Court of Session held that the new chimney was an inseparable and necessary part of a larger entity, the factory. Therefore, the factory rather than the chimney stack was the relevant asset for determining the character of relevant expenditure. The court considered the expenditure on the new chimney to be of a revenue nature. The court noted it was influenced in its decision by the fact the expense incurred in taking down the old chimney and building the substitute was only 2% of the value of the factory. Lord President Cooper stated:[139]

> [T]he facts seem to me to demonstrate beyond a doubt that the chimney with which we are concerned is **physically, commercially and functionally an inseparable part of an "entirety"**, which is the factory. It is quite impossible to describe this chimney as being in the words of Rowlatt, J, the "entirety" with which we are concerned. It is doubtless an indispensable part of the factory, doubtless an integral part; but none the less a subsidiary part, and one of many subsidiary parts, of a single industrial profit-earning undertaking. [Emphasis added]

231. The Commissioner considers the Lord President's reference to the chimney being "commercially … inseparable" does not suggest he considered an item must be an entire profit-making structure to be the relevant asset. Instead, it refers to what a businessperson would see as necessary for the factory to be complete. Even if his Lordship were suggesting this, the New Zealand courts in *Auckland Trotting* and *Hawkes Bay Power* have rejected using a profit-earning structure test to identify the asset in a repairs and maintenance context.

232. The court's decision in *Samuel Jones* differs from that in *O'Grady*, where the chimney was the relevant asset. In *Samuel Jones*, the Commissioners of Inland Revenue argued that they could not distinguish the facts between the two cases. Lord President Cooper, however, referred to Rowlatt J's comment in *O'Grady* that identifying the relevant entirety was "very largely a question of degree" (see [227]). On the facts before him, his Lordship found the chimney was part of the factory. This shows that identifying the relevant asset always depends on the specific facts of each case.

233. Although not clearly stated by his Lordship, the key difference between the cases seems to be that in *Samuel Jones* the chimney was physically connected to the main factory building, while in *O'Grady* the chimney was built a little distance away at another location and was not physically connected to any other structure.

138 *Samuel Jones & Co (Devondale) Ltd v IRC* (1951) 32 TC 513 (IH (1 Div)).

139 At 518.

***Margrett (HM Inspector of Taxes) v Lowestoft Water & Gas Co* (KB)**

234. In *Margrett*, the asset's physical characteristics also appear to have been a deciding factor.[140] The taxpayer company supplied water and gas to the surrounding district. It owned an old reservoir that was too deteriorated to be worth repairing. The taxpayer built a new, much larger and improved reservoir at a different location together with a new water tower. The water tower increased the pressure of the water supply, replacing a gas engine and pumps previously used for this purpose. The reservoir and water tower formed a part of the taxpayer's physical infrastructure for distributing water.

235. The court had to decide whether the expenditure on building the new reservoir was capital expenditure or money "expended for repairs of premises occupied". The court looked to the physical nature and physical distinctiveness of the new reservoir to decide whether it was a separate asset or part of a larger asset. Finlay J stated:[141]

> **Now here the subject matter under discussion seems to me to be the reservoir**, and I cannot think that it is material, though it is undoubtedly the fact, that the reservoir is part only of the Respondents' whole physical undertaking. **It is a part perfectly clearly divisible from the rest**, and it is the part with which we are dealing here. If authority were needed for that I should find it in the decision of Mr. Justice Rowlatt, to which I referred a moment ago, of *O'Grady* v. *Bullcroft Main Collieries, Ltd*, because the reservoir here is more clearly a separate and distinct thing than was the chimney in *O'Grady* v. *Bullcroft Main Collieries, Ltd*. [Emphasis added]

140 *Margrett (HM Inspector of Taxes) v Lowestoft Water & Gas Co* (1935) 19 TC 481 (KB).

141 At 488.

REVENUE ALERT

Provides information about a significant and/or emerging tax issue that is of concern to Inland Revenue.

RA 26/01: Failure to pay PAYE deductions to Inland Revenue

Issued: 16 March 2026

An employer must pay PAYE and other amounts deducted from an employee's salary or wages to Inland Revenue by the due date.

Making deductions and failing to pay them to Inland Revenue is a serious offence carrying a maximum sentence of up to 5 years in prison.

The Commissioner will consider, where appropriate, the possibility of prosecution action where this behaviour is identified. The purpose of this Revenue Alert is to highlight the criminal penalties that may apply.

All references are to the Tax Administration Act 1994.

About Revenue Alerts

Revenue Alerts are issued by the Commissioner and provide information about a significant and/or emerging tax issue that is of concern to Inland Revenue. At the time an alert is issued, risk assessments will already be underway to determine the level of risk and to consider appropriate responses.

A Revenue Alert will identify:

- the issue (which may be a scheme, arrangement, or particular transaction) which the Commissioner believes may be contrary to the law or is inconsistent with policy;
- the common features of the issue;
- our current view; and
- our current approach.

An alert should not be interpreted as being Inland Revenue's final position. Rather, an alert outlines the Commissioner's current view on how the law should be applied. For any alert we issue, it is likely that some investigatory work has already been carried out.

If people have entered into an arrangement similar to the one described or are thinking about it, they should talk to their tax advisor and/or to Inland Revenue for advice about tax implications.

Background

1. An employer must pay PAYE deducted from an employee's salary or wages (and any other related employer deductions, such as for KiwiSaver or student loans) to Inland Revenue by the applicable due date.[1]
2. For more information about employer responsibilities see the **IR335** – Employer's guide.

1 Similarly, a payer that withholds tax from schedular payments made to a contractor must pay these amounts to Inland Revenue by the applicable due date. A payer that fails to do this may also be convicted of a criminal offence and liable for the criminal penalties set out in this Revenue Alert.

Current view

3. An employer who deducts PAYE and related amounts from salary or wages and, knowingly, applies the deductions for a purpose other than in payment to Inland Revenue commits a criminal offence.[2]

4. Any person who aids, abets, incites, or conspires with another person to commit this offence also commits a criminal offence.[3] This means, for example, that the director of a company who decides that the company will not pay the deductions to Inland Revenue may be prosecuted for the company's failure to pay.

5. A person convicted of either the principal offence (paragraph 3) or aiding and abetting (paragraph 4) is liable to: [4]

    - imprisonment for a term not exceeding 5 years;
    - a fine not exceeding $50,000; or
    - both.

6. There are also civil penalties that can apply when an employer makes deductions and does not pay the deductions to Inland Revenue. **Part 5 – Penalties** of IR355 includes information about the civil penalties that can also apply.

7. This Revenue Alert is focused on situations when employers deduct PAYE and related amounts from salary or wages and **fail to pay** the deductions to Inland Revenue. However, employers should also be aware that there are criminal and civil penalties that can apply if they **fail to deduct** PAYE or related amounts from salary or wages when required to do so. These penalties are also discussed in Part 5 of IR355.

Current status

8. The Commissioner considers that deducting PAYE and related amounts from salary or wages and failing to pay the deductions to Inland Revenue poses a significant risk to the integrity of the tax system.

9. The Commissioner will consider, where appropriate, the possibility of prosecution action where this behaviour is identified. Where convicted, a person may be subject to the criminal penalties set out at paragraph 5 of this Revenue Alert.

10. If you consider the concerns outlined in this Revenue Alert may apply to your situation, we recommend you discuss this matter with your tax advisor or Inland Revenue and consider making a voluntary disclosure where applicable.

Authorised by

Daniel Hicks

Domain Lead, Legal Services

Legislative References

Sections 143A and 148 of the Tax Administration Act 1994.

Contact by email

revenue-alerts@ird.govt.nz

Media queries

mediaqueries@ird.govt.nz

2 Section 143A(1)(d). However, a person may not be convicted of this offence if they have paid the deductions to Inland Revenue and their failure to pay them within the prescribed time was due to illness, accident, or other cause beyond their control: s 143A(4).

3 Section 148(1).

4 Sections 143A(8) and 148(2).

BINDING RULING

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

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

BR Prd 26/01: Covenant Trustee Services Limited as trustee of the Goodman Property Trust

Issued | Tukuna: 27 February 2026

The Ruling relates to the Applicant's payment of a distribution to its unitholders and whether this payment is excluded income of the unitholders under s CX 56C of the Income Tax Act 2007.

START DATE – END DATE | RĀ TĪMATA – RĀ MUTUNGA
27/02/2026 – 26/02/2027

Product Ruling | Whakataunga Whakaputanga – BR Prd 26/01

This is a Product Ruling made under s 91F of the Tax Administration Act 1994.

Name of person who applied for the Ruling | Ingoa o te tangata i tono i te Whakatau

This Ruling has been applied for by Covenant Trustee Services Limited as trustee of the Goodman Property Trust.

Taxation Laws | Ture Tāke

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

This Ruling applies in respect of s CX 56C.

The Arrangement to which this Ruling applies | Te Whakaritenga i pāngia e tēnei Whakataunga

1. The Arrangement is the payment of a distribution from Goodman Property Trust (GMT) to its unitholders of an amount equal to the value of its directly held assets on a pro-rata basis. The Arrangement will occur as part of a broader transaction (the Transaction) that involves the contemporaneous corporatisation of GMT and stapling of shares in the 'corporatised GMT' and GMT Manager to form a single tradable security (Stapled Security).
2. Further details of the Arrangement are set out in the paragraphs below.

Background

GMT

3. GMT is an NZX-listed unit trust and a listed portfolio investment entity (PIE).
4. GMT was established by a deed dated 23 April 1999 and amended from time to time. GMT invests in high-quality warehouse and logistics property in New Zealand and has a market capitalisation of approximately NZ$3 billion.
5. As a managed investment scheme under the Financial Markets Conduct Act 2013 (FMCA), GMT is required to have a licensed manager and a licensed supervisor:
   - Covenant Trustee Services Limited acts as the licensed supervisor (and trustee) of GMT (GMT Trustee).
   - GMT Manager acts as the licensed manager of GMT.

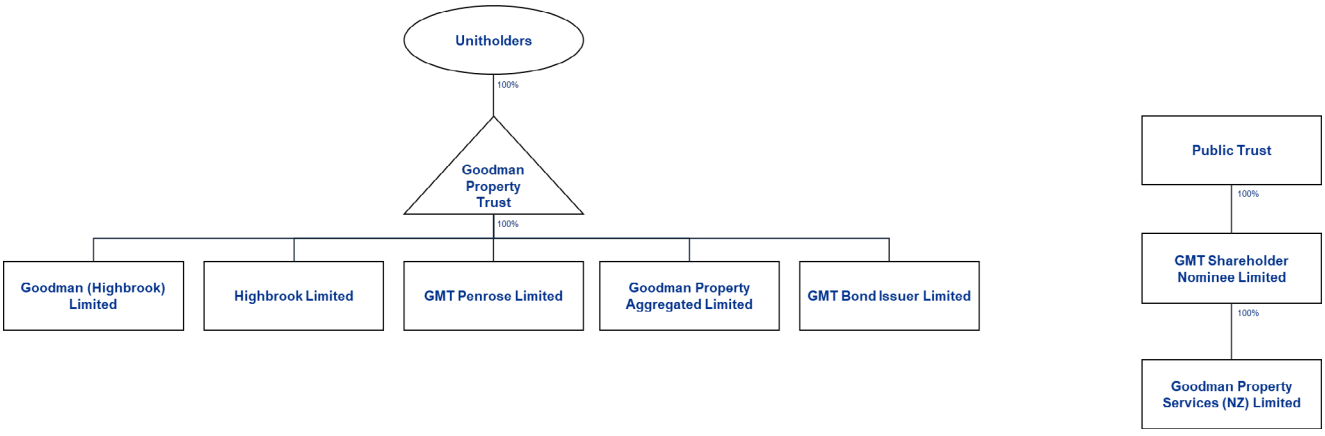
6. GMT's investments are held through its wholly owned subsidiaries:
    - Goodman (Highbrook) Limited;
    - Highbrook Limited;
    - GMT Penrose Limited;
    - Goodman Property Aggregated Limited; and
    - GMT Bond Issuer Limited.

GMT Manager

7. GMT Manager is the licensed manager of GMT.
8. GMT Manager was appointed as manager of GMT in March 2024 as part of an 'internalisation' transaction that involved GMT terminating the agreement with the previous manager, Goodman (NZ) Limited. The internalisation transaction was the subject of private ruling BR Prv 24/07.
9. GMT Manager's only source of income is management fees derived from GMT and the recently established Goodman NZ Highbrook Limited Partnership. GMT Manager is remunerated on a break-even basis. As a consequence of only operating on a break-even basis, the equity value of GMT Manager is nominal.
10. Independence requirements under the FMCA meant GMT Manager could not be associated with the GMT Trustee (the licenced supervisor).
11. GMT Manager is wholly owned by GMT Shareholder Nominee Limited (Management Shareholder), which is a wholly owned subsidiary of Public Trust. The Management Shareholder holds shares in the GMT Manager in accordance with a deed between the GMT Trustee, GMT Manager and the Management Shareholder (Management Deed). The Management Deed requires, among other things, that on certain matters the Management Shareholder act in accordance with directions of the GMT unitholders. The Management Deed establishes a contractual relationship between the Management Shareholder and GMT unitholders. GMT unitholders' rights are enforceable as contractual obligations. The Management Deed does not give rise to a bare trust.

Current structure

12. The following diagram summarises the structure of GMT (showing GMT and its wholly owned subsidiaries only) and GMT Manager.
13. GMT's only assets are its investment in wholly owned subsidiary companies:



Transaction steps

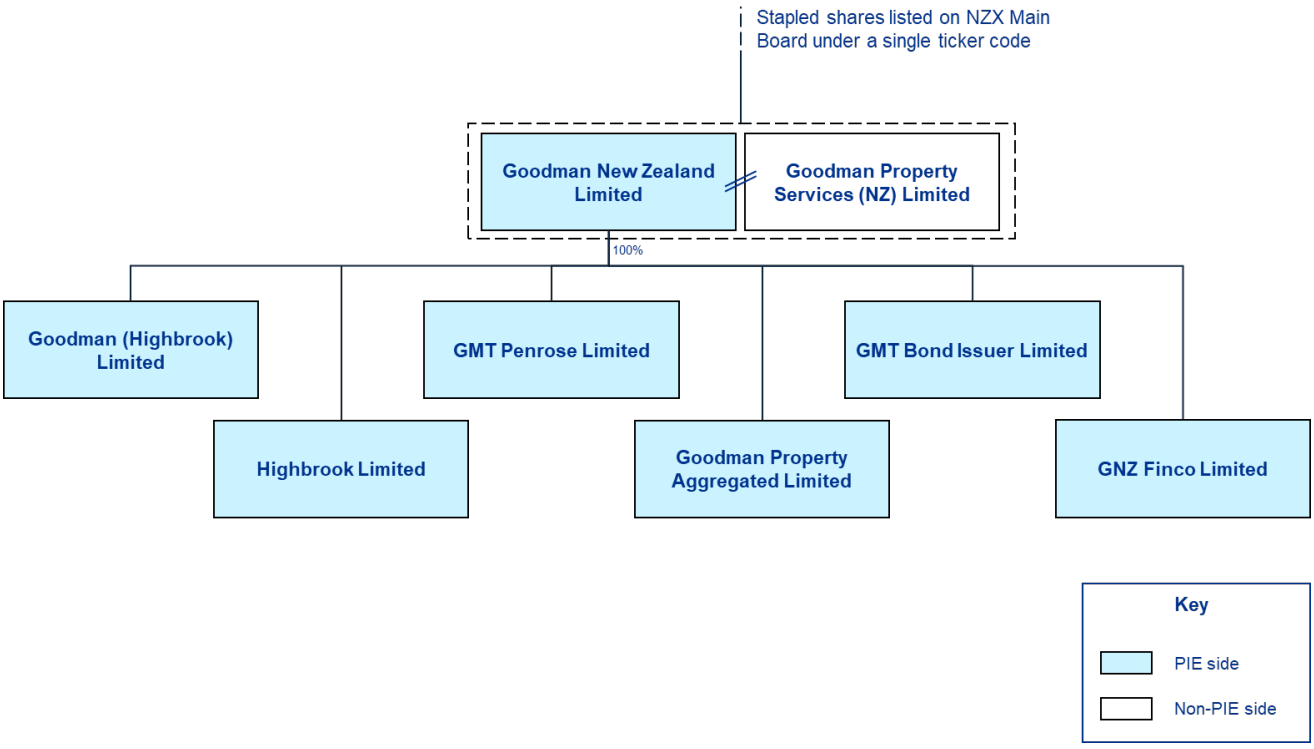
14. The following legal steps will occur at the same time to implement the Transaction:

- A new company, Goodman New Zealand Limited (GNZL) has been incorporated as a wholly owned subsidiary of the Management Shareholder to serve as the 'corporatised GMT'.
- GMT will declare a distribution to its unitholders equal to the market value of its shareholding in its directly owned subsidiary companies. This distribution will be left as a debt owing from GMT to its unitholders (Distribution Debt) to be dealt with as set out in the following steps.
- The unitholders will transfer the Distribution Debt to the Management Shareholder. In turn, the Management Shareholder will transfer the Distribution Debt to GNZL. In exchange, GNZL will issue additional shares as necessary so the total number of ordinary shares it has on issue after this step will equal the total number of GMT units on issue.
- GMT will sell its shareholding in its directly owned subsidiary companies to GNZL for their market value. GNZL will pay the purchase price by way of set-off against the Distribution Debt.
- GMT Manager will undertake a share split so the total number of ordinary shares on issue in the GMT Manager is equal to the total number of GMT units on issue.
- The constitution of each of GNZL and GMT Manager is amended to ensure it is suitable for an NZX-listed company (and in the case of GNZL, an NZX-listed company that is a PIE) and to reflect that the shares in GNZL and GMT Manager are stapled on a one-for-one basis (among other things).

15. The Management Shareholder will do the following:

- For GMT unitholders in New Zealand, Australia or any other jurisdiction where compliance with securities law has been confirmed, the Management Shareholder will transfer Stapled Securities to those GMT unitholders on a one-for-one basis with respect to their GMT unitholding immediately before the Transaction.
- For other GMT unitholders, the Management Shareholder will have their Stapled Securities held by a nominee on a one-for-one basis with respect to their GMT unitholding immediately before the Transaction to assist with the on-market sale of those Stapled Securities. The sale proceeds will then be transferred to these GMT unitholders.

16. The following diagram illustrates the Stapled Security structure following the Transaction (showing GMT Manager, GNZL, and their wholly owned subsidiaries only):



How the Taxation Law applies to the Arrangement | Ko te pānga o te Ture Tāke ki te Whakaritenga

The Taxation Law applies to the Arrangement as follows:

(a) The amount each GMT unitholder derives when GMT pays a distribution equal to the market value of its only assets (being shares in directly owned subsidiary companies) is excluded income under s CX 56C(1) if the unitholder:

(i) is "resident in New Zealand" as that term is defined in s YA 1;

(ii) is a natural person or a trustee; and

(iii) does not include the amount as income in a return of income for the year.

(b) If at least one of the three criteria listed in (a) does not apply to the unitholder, the amount the unitholder derives when GMT pays that distribution is excluded income under s CX 56C(2) to the extent to which the amount is more than the amount that is fully credited as described in s CD 43(26).

Period or income year for which this Ruling applies | Te wā, te tau moni whiwhi rānei i pāngia ai e tēnei Whakataunga

This Ruling will apply for the period beginning on 27 February 2026 and ending on 26 February 2027.

This Ruling is signed by me on the 27th day of February 2026.

Catherine Milner

Senior Tax Counsel | Rōia Tāke
Tax Counsel Office | Te Tari Tohutohu Tāke

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 26/02: Discretionary Investment Management Service fees

Decision date | Rā o te Whakatau: 17 November 2025

Issue date | Rā Tuku: 16 March 2026

Subjects | Kaupapa

This item summarises a private ruling about whether the single global fee charged by a Discretionary Investment Management Services provider is an exempt supply of financial services under s 14 of the Goods and Services Tax Act 1985.

Taxation laws | Ture tāke

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

Summary of facts | Whakarāpopoto o Meka

1. The Applicant is a licensed provider of Discretionary Investment Management Services (DIMS).
2. DIMS are subject to regulation under the Financial Markets Conduct Act 2013 (FMCA).
3. Under a DIMS, the client grants the Applicant full authority to acquire or dispose of financial products on their behalf in accordance with an agreed investment mandate.
4. While the arrangement is in place, the client cannot direct, veto or influence individual investment decisions.
5. Historically, the Applicant allocated its regular service charges into components such as custody, monitoring and transaction fees for GST purposes.
6. The Applicant proposed to charge a single global fee for the DIMS and sought confirmation of the GST treatment of this fee.

Issues | Take

7. The main issues considered in this ruling were:
    - whether the DIMS activities constituted "financial services" under s 3(1); and
    - whether the global fee was wholly for an exempt supply under s 14(1)(a) or whether any component of the fee was for a taxable supply requiring apportionment.

Decisions | Whakatau

8. The Tax Counsel Office (TCO) concluded that:
    - the DIMS activities were exempt financial services under s 3(1)(c), (d), (ka) and (l); and
    - the single global fee was therefore consideration for an exempt supply under s 14(1)(a), except where zero-rating may apply.
    - This conclusion was made on the basis that clients did not retain the ability to direct individual investment decisions after the mandate was agreed.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: Whether the DIMS were a supply of "financial services"

9. Section 3(1) defines "financial services" to include:
    - the issue, allotment or transfer of ownership of a security (s 3(1)(c) and (d));
    - the payment or collection of dividends or similar returns (s 3(1)(ka)); and
    - agreeing to do or arranging any of these activities (s 3(1)(l)).
10. The Applicant directed, traded and managed securities through a custodian. These activities fell within those services listed above.
11. The Commissioner's interpretation statement IS 25/05[1] discusses the term "arranging". It notes that the courts have interpreted the term broadly to include "causing to occur", "planning for" and "making preparations for" a transaction (see *Databank Systems Ltd v CIR* (1987) 9 NZTC 6,213).
12. The Applicant caused investment decisions to occur through the custodian, satisfying this test.
13. In *Canadian Medical Protective Association v R* [2009] FCA 115, the Federal Court of Appeal held that investment managers' activities – including research, analysis and monitoring – were internal inputs into the arranging of securities transactions.
14. The court said that even though research was the dominant internal activity, the service supplied to customers was the execution of discretionary investment decisions, which constitutes arranging the transfer of securities.
15. These principles apply directly to DIMS. The Applicant undertook monitoring, review and research so that it could exercise its discretionary mandate. These activities were not separate supplies it made to the client.
16. The Applicant did not advise clients on proposed transactions. The exclusion in s 3(1)(l) for "advising thereon" was therefore not engaged.
17. In *J R Moodie Co Ltd v MNR* [1950] 2 DLR 145, the court interpreted "advising" as recommending or giving an opinion. DIMS agreements expressly avoid client involvement and do not require the Applicant to offer recommendations.

Issue 2 | Take tuarua: Whether administrative and reporting services were incidental

18. Section 14(1)(a) exempts financial services from GST together with any services that are "reasonably incidental and necessary" to those financial services.
19. The FMCA requires DIMS providers to produce regular portfolio reports, maintain records and oversee custody arrangements.
20. Reporting, custody administration and compliance functions are necessary to operate DIMS.
21. IS 25/05 considers managed fund managers' administration activities – including registry services, fund accounting, the management of financial transactions between a member and the scheme, and the management of PIE tax obligations – to be exempt when they are incidental to the supply of financial services.
22. Because DIMS providers perform comparable functions, TCO considered this reasoning applies to their activities by analogy.
23. IS 0052[2] requires providers to apportion fees where they supply advisory, planning or monitoring services. This requirement did not apply in this situation because:
    - the Applicant did not provide advice;
    - monitoring was not a service the Applicant supplied to the customer; and
    - the supply was discretionary investment management, not financial planning.

1 IS 25/05: GST treatment of fees paid in relation to managed funds *Tax Information Bulletin* Vol 37 No 4 (May 2025).

2 IS 0052: Financial planning fees – GST treatment *Tax Information Bulletin* Vol 13 No 7 (July 2001): 37.

Issue 3 | Take tuatoru: Whether the fee must be apportioned

24. Section 10(18) requires apportionment only where a single consideration relates to both taxable and exempt supplies.

25. The Court of Appeal in *CIR v Smiths City Group Ltd* (1992) 14 NZTC 9,140 held that a global fee must be split only where a provider makes distinct taxable and exempt supplies.

26. Likewise, in *Chatham Islands Enterprise Trust v CIR* [1999] 19 NZTC 15,075, the court held that GST liability depends on the true legal character of what is supplied.

27. The DIMS Agreement provided a single supply: discretionary investment management. The Applicant had no contractual obligation to supply monitoring, planning, advisory or evaluation services that could constitute taxable supplies.

28. Because administrative tasks are incidental to the financial service under s 14(1)(a), and the Applicant did not supply any separate taxable, there was no basis on which to apportion the global fee.

Conclusion

29. The activities the Applicant carried out fell within the definition of financial services under s 3(1).

30. The global DIMS fee was therefore fully exempt from GST under s 14(1)(a).

31. The Applicant was not required to apportion fees because it supplied only exempt services.

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

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.