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Tax treatment of feasibility and black hole expenditure: further consultation

Introduction

The New Zealand Law Society appreciates the opportunity to comment on the revised proposed policy response to the issue of feasibility and black hole expenditure, set out in IRD's paper of 12 September 2017 (Paper). The Law Society is generally supportive of the approach outlined in IRD's Paper, subject to the comments below.

Comments

Increasing certainty for taxpayers

The Paper proposes that whether feasibility expenditure is deductible or non-deductible capital expenditure continues to be determined under the existing legislation, with Interpretation Statement: IS 17/01 *Income tax – deductibility of feasibility expenditure* (IS 17/01) being used as an interpretive guide.

Any legislative amendments would therefore be limited to addressing "black hole" outcomes for certain categories of non-deductible capital expenditure. As the *Trustpower* case illustrated,[1] while Interpretation Statements may be useful to taxpayers and Inland Revenue, they are not binding on either party and can be of little relevance in a dispute (including to a court).

IS 17/01 deals only with recurrent feasibility expenditure

The Law Society suggests that the proposed approach be evaluated against an alternative that gives greater certainty to taxpayers at the first step, for example by supplementing the general rules with a provision that allows an immediate deduction if the expenditure does not give rise to an asset under IFRS. Such an approach would appear to be consistent with the proposed approach at the second step, whereby a deduction would be allowed if expenditure previously capitalised for tax purposes is subsequently expensed or impaired under IFRS because the asset or project has been abandoned or materially altered.

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1 *Trustpower Limited v Commissioner of Inland Revenue* SC 74/2015 [2016] NZSC 91

The Law Society notes that IS 17/01 applies only to "recurrent" feasibility expenditure, and does not cover irregular or one-off feasibility expenditure (see, for example, paragraphs 1, 15 and 128 of IS 17/01). IS 17/01 merely states that the deductibility of such expenditure be determined under ordinary principles. Therefore, if IS 17/01 is to be used as a guide to determine whether expenditure is immediately deductible (as the Paper proposes), and is not supplemented by a specific deductibility rule, a high degree of uncertainty will remain for taxpayers that do not engage in recurrent or regular feasibility activities. The Law Society submits that further guidance should be given in relation to such expenditure, either by amending IS 17/01 or through a separate statement.

Deductibility where buildings are not ultimately acquired or constructed

It is not clear to the Law Society that a deduction should be denied for expenditure incurred in making tangible progress towards a project that would, if completed, include the construction or acquisition of a building, but which is abandoned or materially altered so that the building is not in fact acquired or constructed.

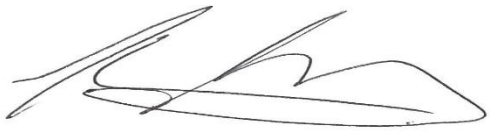
In these circumstances, the policy rationale for the 0% depreciation rate on buildings does not seem applicable.

By way of illustration, if in example 3 described in the Paper, the blueprints for the plant included designs for a building (and the proposal was subsequently abandoned or the blueprints needed to be scrapped for new ones), there appears to be no good reason why the expenditure relating to the building plans should not be deductible.

Conclusion

This submission was prepared with the assistance of the Law Society's Tax Law Committee. If you wish to discuss this further, please contact the committee's convenor, Neil Russ, via the committee secretary, Jo Holland (jo.holland@lawsociety.org.nz, (04) 463 2967).

Yours faithfully



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