NEW ZEALAND LAW SOCIETY
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29 October 2013

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Dear Ainsley

The treatment of expenditure incurred for dual outcomes

1. Thank you for your letter of 24 September 2013 inviting the New Zealand Law Society's Tax Law Committee to comment on the issue of how expenditure should be treated when it simultaneously achieves two outcomes.

2. We make the following comments in response to the various questions raised by the Interpretation Statement on interest deductibility (TIB Vol 8 No6 July 2006).

Should the principle that dual outcome expenditure does not give rise to apportionment be limited to situations where the dual outcomes are income and capital given the inherent connection between interest, borrowed funds and capital gains?

3. This proposition was addressed at paragraphs 124 – 126 of the Interpretation Statement. The conclusion reached was that the New Zealand case law stood for a broader principle, that interest expenditure was fully deductible so long as all the funds were fully committed to producing income, with no requirement that the non-income outcome be a capital one. The Law Society considers this is the proper interpretation of the case law. Indeed, *Public Trustee* (which forms the basis of the Interpretation Statement) was a case in which the concurrent outcome was not a capital outcome but simply a non-income one (payment of a tax debt).

4. The Law Society notes, as an aside, that all of the notable New Zealand cases in this area have been decided under former specific interest deductibility provisions. The language of these provisions did not contain the qualification, which appears in the general permission, limiting deductions "to the extent to which" the expenditure is incurred in deriving assessable income etc. The former language did contain the qualification "except so far as the Commissioner is satisfied…". We wonder whether the "to the extent to which" formulation might more naturally call for an apportionment, not only in time/space type scenarios, but also in dual outcome scenarios.

5. However, this possibility was addressed (and discounted) in Richardson J's judgment in *Pacific Rendezvous* at page 571, where His Honour compared sections 104 and 106(1)(h) and concluded:

> *"But it was not suggested that s 104 could impose a more stringent test of deductibility in this class of case and it was accepted for the Commissioner that if and to the extent that the interest expended satisfied s 106(1)(h) it would also satisfy s 104. Accordingly it is not necessary to refer further to s 104 except to note that the language of both provisions — "to the extent to which" in s 104 and "so far as" in s 106(1)(h) — expressly contemplates apportionment."*

6. It is perhaps significant, for present purposes, that the Commissioner himself accepted that in that context, while both "to the extent to which" and "so far as" contemplate a time/space apportionment where applicable, neither contemplates an apportionment in relation to dual outcome expenditure.

7. The position in New Zealand therefore appears to be settled, that once it is established that an expenditure is incurred 100% for income earning purposes, the fact it is also incurred 100% for some other purpose does not engage an apportionment requirement under the language of the general permission.

Change of focus from looking at the use of funds to the degree of connection with income

8. Again, this point was comprehensively analysed at paragraphs 22 – 24 of the Interpretation Statement. It concluded that the considerations under both provisions will ordinarily be the same and therefore the change did not make any material difference generally or in a dual outcome context. In light of *Pacific Rendezvous* and subsequent cases, this conclusion is robust.

Decision in Ronpibon Tin may provide support for apportionment of dual outcome expenditure

9. It seems to the Law Society that there is simply a divergence of view between the New Zealand and Australian courts as to the significance, in a dual outcome context, of the "to the extent to which" language appearing in the New Zealand general permission and its Australian equivalents. The finding in *Ronpibon Tin* that the relevant dual outcome (being income and capital) expenditure on directors' fees should be apportioned, was clearly driven by the words "to the extent to which" appearing in section 51(1) of the Income Tax Assessment Act 1936-1944 (see, in particular, the judgment of the High Court at pages 55 and 58 – 59). As noted above, the Court of Appeal in *Pacific Rendezvous* did not think that the same words appearing in the New Zealand general permission had this effect. Against that background, it is difficult to see how the Commissioner could advocate a *Ronpibon Tin* approach unless the matter is first revisited by the New Zealand courts or there is a legislative change. (We note we have not yet had a chance to see how the *Ronpibon Tin* principle has developed in Australia.)

No wider principle appears to have been applied

10. We do not perceive any particular significance in the fact that no wider principle appears to have been applied. This may simply reflect the relative infrequency with which these matters arise in practice.

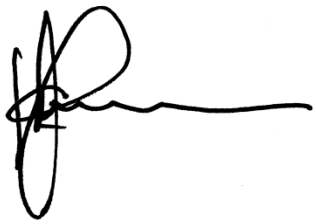
Examples where the issue might be relevant

11. The issue arises conceptually in practice in the context of expenditure, such as administrative expenses, incurred by a tax charity in deriving business income, where the charity's charitable purposes are not limited to New Zealand. However, given that section CW 42(4) itself expressly calls for an apportionment of the relevant business income, the practical approach has been to apportion any related dual outcome (for example assessable/exempt) expenditure on a pro rata basis.

Conclusion

11. We hope you find the above comments helpful. If you wish to discuss this further, please do not hesitate to contact the Tax Law Committee convenor Neil Russ, through the committee secretary Rhyn Visser (04 463 2962, rhyn.visser@lawsociety.org.nz).

Yours sincerely



Chris Moore
President