Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Bill

Commentary on Supplementary Order Paper No. 167 to the Bill

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Salary trade-offs

OVERVIEW

An officials' issues paper, *Recognising salary trade-offs as income*, was released in April 2012. The paper suggested various changes to bring a wider set of salary substitutes into income for tax and social assistance purposes. Cabinet considered feedback on those suggestions and announced its decisions in October. The proposed changes in the bill give effect to those decisions.

Conceptually, anything that an employer provides to an employee that is salary or wages, or is a substitute for salary or wages, should be taxed, subject to the practicality of doing so. Currently, salary and wages are treated as employment income and are subject to withholding tax (PAYE), while most non-cash benefits received as a result of employment are treated as fringe benefits and are subject to fringe benefit tax (FBT). The overall effect of PAYE and FBT is intended to be the same, so that cash and non-cash benefits are taxed equivalently.

In many instances, benefits gained in a salary trade-off, such as the availability of an employer-provided vehicle, are taxed through the FBT rules. There are, however, instances in which neither a salary substitute, nor the salary traded off are taxed. A key example of this is a parking space provided on the employer's premises.

Furthermore, many non-cash benefits provided as part of a salary trade-off are not currently included in the definition of "family scheme income", and are therefore not taken into account in determining social assistance entitlements and obligations.

A key principle of tax policy is horizontal equity – ideally a tax should apply equally to people on the same effective income. The proposed rules enhance the integrity of the tax and social assistance systems, meaning greater fairness between those who receive non-cash benefits as part of their remuneration, and those who receive only cash remuneration.

The new rules balance achieving a more equitable and efficient outcome against the compliance cost associated with doing so. For compliance reasons, the rules therefore primarily focus on the largest benefits which are currently not taxed.

Many submitters indicated that they would prefer a simple rule focussed on the most obvious salary trade-off situations. However, it soon became apparent that such a rule would likely be impractical to apply. There would be a strong risk that it would lose its effectiveness as taxpayers altered their arrangements over time by, for example, switching away from salary trade-offs that explicitly offer a cash alternative. Therefore, to achieve a robust solution the proposed approach has needed to cover both implicit and explicit salary trade-offs and to provide detailed rules about what situations are covered.

Key changes

There are two key areas of change.

The first involves taxing a wider set of car parks, through the FBT rules. The new rules would apply predominantly to car parks provided to employees in the central business districts of Auckland and Wellington (the areas where the benefits to employees are the greatest). A parking space provided to an employee outside of those defined areas would also be included if the parking space was supplied to the employer for more than $210 per month, or if the employee had explicitly traded off an amount of employment income for the parking space.

The new rules replace the current on-premises/off-premises distinction for determining whether a parking space is subject to FBT. Difficult interpretive issues are raised by the need to distinguish between parking benefits which are provided on the employer's premises and parking benefits which are not.

The second major change is to include explicit salary trade-offs involving vehicles and parking spaces, as well as vouchers (such as grocery or petrol vouchers) in the definition of "income" used when calculating social assistance entitlements and obligations.

Other changes include clarifying that the charitable organisations' FBT exemption will not, subject to the minimum thresholds, extend to vouchers.

Application date

All amendments will apply from 1 April 2014.

WHEN A PARKING SPACE MAY BE A FRINGE BENEFIT

(Clauses 12C, 12D, 13B and 13D)

Summary of proposed amendments

The following changes are proposed:

- Clause 12C will remove the provision of motor vehicle parking from the category of "unclassified benefits".
- Clause 12D will set out a new rule which determines when the provision of a parking space to an employee is a fringe benefit.
- Clause 13B will remove the provision of motor vehicle parking from the "on-premises" FBT exemption.
- Clause 13D will further set out that a benefit in the form of the availability of an area for parking a motor vehicle is not a fringe benefit, other than as described in the new rules in clause 12D.

Key features

The proposed amendments will widen the range of taxable parking benefits. They will remove the distinction between parking benefits which are provided on the employer's premises and car park benefits which are not provided on-premises. They will also ensure that car park benefits outside of the new rules will not be treated as a fringe benefit.

Under the current rules, benefits that are provided by an employer and used or consumed by the employee on the premises of the employer are exempt from FBT. Clause 13B will remove the provision of motor vehicle parking from this "on-premises" exemption. To ensure that a range of car park benefits do not become unintentionally taxable as a result of this change, clause 13D clarifies that a benefit in the form of the availability of an area for parking a motor vehicle is not a fringe benefit, except as set out in proposed section CX 9B (clause 12D). Given the specific car park rules in new section CX 9B, clause 12C clarifies that the provision of motor vehicle parking is no longer an unclassified fringe benefit.

Proposed section CX 9B sets out when the availability of a parking space will constitute a fringe benefit. This will only happen if an employer makes a parking space available in any of the following situations:

- The parking space is in a specified urban area. These areas are the central business districts of Auckland and Wellington and are marked as the "Central Area" on the respective District Plans. The provisions in the Supplementary Order Paper No. 167 also provide that the Governor-General may, by Order in Council, add or remove an urban area, or vary the boundaries of an urban area within which a fringe benefit may arise.

- The parking space is provided to the employer by a commercial car park operator and the consideration paid by the employer is more than the specified amount. That specified amount is set at $210 per month. The Governor-General may, by Order in Council, vary this amount.
- When the employee would be entitled to a greater amount of employment income had they chosen to not receive the parking space.

The benefit is calculated on a daily basis for each employee. The tax treatment of parking spaces will differ depending on whether the space is specifically allocated to an employee.

Allocated spaces

Allocated spaces are those which are assigned to specific employees. A space which is specifically allocated to an employee may or may not have that employee's name displayed on it.

If a specific parking space is allocated to an employee, a fringe benefit of one parking space will arise on a day if the employer makes the space available to the employee, and the use of that space is not restricted to what the proposed provisions refer to as a "business or certificated vehicle".

The term "business or certificated vehicle" refers to vehicles which either have a valid disabled parking permit, are work-related vehicles (as defined in section CX 38 of the FBT rules), or are essentially fleet cars. In the case of a fleet car, the car has to be owned or leased by the employer, be made available to multiple employees for business purposes during business hours, and not be made available for private use of employees (other than travel which arises incidentally to travel for business purposes). Home to work travel is specifically not considered to be incidental travel.

Example

Company A is located on Fort Street in Auckland. One of its employees, Morgan, is allocated a parking space in the building. On weekdays she is only allowed to park the work-related vehicle which she drives in the space. During the weekend, however, she is allowed to park her own car in the space.

A fringe benefit of one parking space arises on two days, Saturday and Sunday.

Unallocated spaces

Where spaces are not specifically allocated to employees, employees can generally park in whichever space they choose. The provisions in Supplementary Order Paper No. 167 refer to these unallocated spaces as "pool parking spaces", and carve out spaces which are allocated to the sole use of one employee, or of people other than employees (such as spaces specifically designated for customers). The SOP refers to employees who may park in one of these pool parking spaces as "pool users".

There may or may not be a sufficient number of pool parking spaces to ensure that all pool users are able to park on any given day. The provisions propose a slightly different tax treatment depending on whether there are or are not enough pool parking spaces for all pool users. This is because when there are fewer pool parking spaces than pool users, there is no certainty that a space will be available when an employee wants to park. Conversely, when the number of pool parking spaces is equal to or greater than the number of pool users, an employee can be more confident that they will be able to find a parking space.

When the number of pool parking spaces is equal to or greater than the number of pool users, a fringe benefit will arise from the employer making available a pool parking space to an employee on a day, unless the employee is restricted on the day to the use of the space for a business or certificated vehicle, or is restricted to parking outside the hours 6am to 10pm. This recognises the fact that public transport may not be readily available during these hours. It also recognises the fact that two employees may be parking in the same space at different times during the day and night.

Example

Company B is located on Brandon Street in Wellington and provides parking for its employees. It has 20 parking spaces, but only 14 employees. One of its employees drives a vehicle with a disabled parking permit and can only park that vehicle. The other employees do not drive business or certificated vehicles.

A fringe benefit arises each day for the 13 remaining employees.

When the number of pool parking spaces is less than the number of pool users, the following formula is used to calculate an appropriate fraction of a parking space to assign to each employee for each day:

$$\frac{\text{Parking ratio x (day users – business)}}{\text{(day users)}}$$

The formula takes into account the number of "day users". A day user is a pool user who, on that day, has hours of employment both beginning and ending between 6am and 10pm. When employees are restricted to the use of pool parking spaces outside the hours of 6am to 10pm, no fringe benefit arises.

The formula subtracts from the total number of day users the number of business users, that is, the number of day users who, on that day, are restricted to the use of a pool parking space for parking a business or certified vehicle between 6am and 10pm. This number is multiplied by a "parking ratio". The parking ratio is 1 if the number of day users is less than or equal to the number of pool parking spaces. Otherwise, the parking ratio is the number of pool parking spaces divided by the number of day users. The resulting number is then divided by the number of day users in order to calculate a fraction that determines the fringe benefit for each employee.

Example

Company C is located on Lambton Quay in Wellington. It has 50 parking spaces, and all 90 employees are told that they can park there. Parking works on a first-come, first-served basis.

On Monday, 70 employees are rostered to work. Sixty five of them will be working from 7am until 7pm. The other five will be working from 11pm until 5am restocking merchandise. They may only park while they are working. Three of the employees working during the day are only allowed to park work-related vehicles in the parking building. Employees who are not working on Monday are not allowed to park in the parking building.

The number of pool parking spaces (50) is less than the number of pool parking users (70). The number of day users is 65. As the number of day users is more than the number of pool parking spaces, the parking ratio is $^{50}/_{65}$ (the number of pool parking spaces divided by the number of day users).

Company C therefore calculates its fringe benefit tax liability using the formula:

$$\frac{\text{Parking ratio x (day users – business)}}{\text{(day users)}}$$

$$\frac{^{50}/_{65} \text{ x } (65 - 3)}{65} = 0.734$$

A fringe benefit arises on Monday for the 65 day users of a fraction of a parking space. Each of the 65 day users receives 0.734 of a parking space.

No fringe benefit arises on Monday for the five employees who are restricted to using the pool parking spaces for their night time shift.

No fringe benefit arises on Monday for the 20 employees who are not working on that day, because they are only allowed to park if they are working on that day.

Background

Most non-cash benefits provided by an employer to an employee in connection with their employment are fringe benefits, and are subject to fringe benefit tax. There is, however an exemption for non-cash benefits which are used or consumed on the employer's premises, primarily for compliance reasons. Most, but not all, benefits from the availability of parking spaces are exempt from FBT because of this exemption. Difficult interpretative issues are raised by the need to distinguish between whether a parking space is or is not on an employer's premises. The current interpretation of "premises" is based on a common law interpretation, under which a leased car park, like one owned by the employer, is exempt from FBT, whereas a licensed car park is not exempt.

VALUE OF CAR PARK FRINGE BENEFIT

(Clause 44B)

Summary of proposed amendment

Proposed section RD 33B sets out the daily value for a fringe benefit which arises from the availability of a parking space. It also permits an employer to use a parking test period, and to obtain daily average figures. It further sets out that it overrides the valuation rules in section RD 41, except when an employer is a commercial car park operator.

Key features

Proposed section RD 33B sets out the value of a fringe benefit arising from the availability of a parking space. It sets out three different values which may apply, depending on the circumstances in which the parking space was provided. Each of these values is expressed as a daily value.

When the parking space is provided by a commercial car park operator, the value of the parking space is equivalent to the amount charged by the car park operator to the employer for the parking space. This value applies regardless of where in the country the parking space is located, or whether the employee has opted to receive a smaller amount of employment income in exchange for access to the parking space. Other provisions, as noted earlier, determine what parking spaces are subject to FBT.

The Commissioner of Inland Revenue will also set a standard value. This value is to be used if the parking space is in the Central Area of either Auckland or Wellington and is not provided by a commercial car park operator. This value is likely to be $250 per month, converted to a daily value. It is to be used regardless of whether the employee has opted to receive a smaller amount of employment income in exchange for access to the parking space. When the parking space is not supplied to the employer by a commercial car park operator, there may be no easy way for the employer to determine the value of that parking space. The standard value is therefore intended to overcome this concern.

If the parking space is not provided by a commercial car park operator, and is not in the Central Areas of Auckland or Wellington, it can only be a fringe benefit if the employee would have been entitled to a greater amount of employment income had they opted not to receive the parking space. In this case, the value of the fringe benefit is the amount of extra employment income the employee would have been entitled to, had they chosen not to receive the parking space.

Normally, the fringe benefit tax will be the full daily value. However, when there are fewer pool parking spaces than pool users, an employee may have received a fraction of a parking space under proposed section CX 9B (3)(d). In that case, the value of the fringe benefit for the employee is that fraction multiplied by the appropriate daily value as set out above.

Section RD 54(2) already takes into account contributions made by employees in determining the value of fringe benefits. This section will also apply to parking spaces to recognise amounts paid by employees for a parking space.

With one exception, proposed section RD 33B will override the valuation method set out in section RD 41. Section RD 41 is used to value services provided by an employer to an employee when those services are a fringe benefit. The valuation method set out in section RD 41 will apply if a commercial car park operator is also the employer. In such cases the daily value will be the amount the commercial car park operator charges an independent third party for a parking space.

PARKING TEST PERIOD

(Clause 44B)

Summary of proposed amendment

Proposed section RD 33C sets out the requirements for a parking test period.

Key features

Proposed section RD 33C allows employers to record the use of parking spaces by employees for a test period in order to obtain daily average figures. The quantities from the test period can then be applied for a term of up to three years.

An employer choosing to use a parking test period must choose a period which shows, or is likely to show, a pattern of the use of the parking spaces which fairly represents the use over the whole of the term. The test period must be for a continuous period of two months or more. An employer might choose a longer period, for example, if their business had large seasonal variations in numbers of employees such that any two-month period was unlikely to be typical for the year.

The employer can choose to end the term before the end of the three-year period. If they do so, they cannot continue to use the test quantities they obtained during the test period.

Proposed section RD 33C also sets out two other circumstances in which the employer must not continue to use the test quantities.

The first is when the Commissioner gives the employer a notice informing them that the Commissioner considers the test quantities do not fairly represent the use of parking spaces. This notice will contain a date after which the employer must not continue to use the test quantities.

The other situation is when, as relevant, either the number of pool parking spaces or the number of pool users exceeds the test quantity obtained for that item by 10 percent or more. An employer will only need to monitor one of these items. The value which an employer must consider is whichever of the number of pool parking spaces or the number of pool users was the smaller number when they recorded their test quantities. If, in a return period, the current number representing that item exceeds the test quantity by 10 percent or more, the employer must not continue to use the test quantities after the end of that return period. The 10 percent threshold has been chosen because it is considered to represent a significant change in circumstances and, therefore, overall FBT liability.

Background

Test-period provisions exist elsewhere in the Income Tax Act; for example, in the fringe benefit rules in relation to motor vehicles.

ATTRIBUTION OF CAR PARK FRINGE BENEFITS

(Clauses 44D and 44E)

Summary of proposed amendment

If an employer provides a parking space to an employee and that parking space is within the ambit of proposed section CX 9B which sets out the ambit of the rules, the proposed amendment to section RD 47 requires the employer to attribute the benefit to that employee.

Clause 44E proposes to amend section RD 48 so that when making a parking space available to multiple employees, an employer does not have to attribute the benefit to the employee who mainly uses or receives the benefit. It further allows employers to pool the value of benefits, if the formula in section CX 9B (3)(d) applies to the benefits.

Key features

Employers are required to attribute certain fringe benefits to employees. These fringe benefits are set out in section RD 47 of the Income Tax Act 2007. Clause 44D proposes to add the provision of a parking space which is covered by proposed section CX 9B to this list of attributable items, irrespective of the value of the benefit. Employers will still be able to choose to pay FBT at a single higher rate if they choose. Furthermore, when the benefit is an unallocated parking space where there are fewer spaces than employees (so that section CX 9B(3)(d) applies), the employer will have the choice of attributing the fraction of a parking space to the individual employee or pooling the benefits under section RD 53.

Clause 44E also proposes an amendment to section RD 48 so that employers are not required to determine which employee mainly uses or receives the benefit of a parking space. This is relevant when an employer does not allocate parking spaces to specific employees.

Background

Attribution enables the employer to pay fringe benefit tax at a level which reflects the employees' specific tax rates.

Section RD 48 currently sets out that if an employer provides a fringe benefit (which must be attributed) to more than one employee, they must attribute the benefit to the employee who mainly uses or receives the benefit. It further states that if the employer cannot determine which employee mainly uses or receives the benefit they must pool that benefit. Under section RD 48, if an employer cannot determine which employee mainly uses or receives a benefit they must pool the benefit (under section RD 53). The tax rates required to be used under this pooling section may be higher than the tax rates of the employees actually receiving the benefits.

POWER TO MAKE DETERMINATIONS ON CAR PARK VALUE

(Clause 67C)

Summary of proposed amendment

The provisions in this Supplementary Order Paper No. 167 give the Commissioner the power to make determinations on the value of a fringe benefit arising from the availability to an employee of a parking space in the Central Areas of Auckland and Wellington.

Key features

The amendment (proposed section 91AAT of the Tax Administration Act) will allow the Commissioner to determine the value of the availability of a car parking space in the Central Areas of Auckland and Wellington. The determination may apply for a period of time specified in that determination. Within 30 days of issuing or changing a determination, the Commissioner must publish a notice in a publication chosen by the Commissioner which gives notice that the determination has been issued or changed, and states where copies of the determination can be obtained.

This Commissioner power will extend to other urban areas should they be added by Order in Council to the list of specified areas.

The Commissioner must take market rates for parking spaces into account in determining an appropriate value for the urban area.

Background

As set out in proposed section RD 33B, the daily value of the availability of a parking space will sometimes be the amount set by a determination of the Commissioner. This will occur when the parking space is not provided by a commercial car park operator, but is located within the Central Areas of Auckland and Wellington, as set out in the respective District Plans of those cities.

When the parking space is not supplied to the employer by a commercial car park operator, there may be no easy way for the employer to determine the value of the car park. The reason for using a value set by the Commissioner is, therefore, intended to resolve this issue.

SHORT-TERM CHARGE FACILITIES AND FRINGE BENEFIT TAX

(Clauses 13C and 44C)

Summary of proposed amendments

Section CX 25 of the Income Tax Act 2007 will be amended to clarify that vouchers are a form of short-term charge facility.

Section CX 25 will also be amended to cap the threshold under which a benefit provided by a charitable organisation in relation to a short-term charge facility does not constitute a fringe benefit.

Key features

Definition clarification

Section CX 25 of the Income Tax Act 2007 will be amended to clarify that vouchers are a form of short-term charge facility.

Comparable changes will be made to section RD 39 that sets out the value of short-term charge facilities. It will be amended to include an amount that an organisation pays for or towards consideration, other than money or money's worth for the goods and services obtained by an employee under the short-term charge facility.

This revised definition is also used in proposed section MB 7B.

Capping the minimum threshold

Currently a benefit provided to an employee of a charitable organisation by way of a short-term charge facility has to exceed 5 percent of the employee's salary or wages for the tax year before it is treated as a fringe benefit. This threshold will be capped so that a fringe benefit will arise if the aggregate value of the short-term charge facility benefits in a tax year is more than the lesser of 5 percent of the employee's salary or wages for the tax year, or $1,200.

Background

Charitable organisations are generally exempt from fringe benefit tax. Currently, one exception to this exemption is when the charitable organisation provides a benefit to an employee by way of a short-term charge facility, and the value of the benefit for the employee in a tax year is more than 5 percent of the employee's salary or wages.

The first of the proposed changes described above clarifies that if a charitable organisation provides its employees with vouchers, those arrangements will be subject to FBT unless they are below the threshold.

The second change ensures that the exemption threshold is set at a level that recognises potential compliance costs but protects the revenue base.

FAMILY SCHEME INCOME FROM EMPLOYMENT BENEFITS

(Clause 39B)

Summary of proposed amendment

Proposed section MB 7B will require employees who receive certain non-cash benefits to include them in their family scheme income calculations. The availability of an employer-provided parking space or motor vehicle will be included if it is part of an explicit salary trade-off – that is, if the employee would be entitled to a greater amount of employment income if they chose not to receive the non-cash benefit. An employee who receives short-term charge facilities will also be required to include these if the value of benefits received in a year is more than the specified threshold.

"Family scheme income" is used to calculate entitlements and obligations for a number of different forms of social assistance. This amendment will see the above types of non-cash benefits taken into account for Working for Families tax credits, the student allowances parental income threshold, and community services card entitlements. Subsequent amendments will be made to include the same benefits in income for child support and student loan repayment purposes once the Child Support Amendment Bill and the Student Loan Scheme Amendment Bill (No 2) have been enacted.

Proposed section MB 7B sets out the value of benefits to be included in family scheme income.

These changes will affect people's entitlements and obligations for those periods that include income derived on or after 1 April 2014.

Key features

New section MB 7B will only apply to persons to whom section MB 8 does not apply. Section MB 8 sets out what an employee who is also a controlling shareholder must include in their family scheme income. The rules for controlling shareholders are not being changed.

If an employee receives a motor vehicle or parking space from their employer, and the employee would be entitled to a greater amount of employment income if they chose not to receive the non-cash benefit, that benefit will be included in the calculation of family scheme income, regardless of its value or where in the country the parking space is located. The amount which the employee would be required to report would be the amount by which their employment income would be greater in the absence of one of the above benefits.

Employees will also be required to include short-term charge facilities they have received in family scheme income in certain situations. This will only be when the value of the benefit provided under short-term charge facilities provided in an income year (not including the fringe benefit tax payable on the benefits) is more than the lesser of 5 percent of the employee's salary or wages for the tax year, or $1,200. This threshold is included to reduce potential compliance costs. The amount the employee will be required to include will be the value of the short-term charge facilities, including any fringe benefit tax. This requirement applies to employees of all entity types, not just charitable organisations.

By inserting section MB 7B, these three types of benefits will be taken into account for forms of social assistance which base their calculations on section MB. These will be Working for Families tax credits, the parental income test for student allowances, and entitlements to community services cards.

Background

A key principle of tax policy is horizontal equity – ideally a tax should apply equally to people on the same effective income. When a non-cash benefit is provided as a substitute for salary or wages, if it is not included in family scheme income in the way that salary or wages would be, inequity arises. This change is, therefore, designed to achieve greater fairness.

The focus is on including the likely main benefits. Short-term charge facilities, such as vouchers, are included because they are a readily substitutable alternative to salary and wages even when a specific amount of cash has not been traded off.

FAMILY SCHEME INCOME FROM FRINGE BENEFITS, CONTROLLING SHAREHOLDERS

(Clause 39C)

Summary of proposed amendment

The heading of section MB 8 of the Income Tax Act 2007 will be amended to specifically refer to controlling shareholders.

Key features

A specific reference to controlling shareholders who are also employees will be added to the heading of section MB 8 of the Income Tax Act to avoid confusion with proposed section MB 7B which applies to other employees.

Background

Section MB 8 requires a fringe benefit which is required to be attributed to an employee who is a controlling shareholder to be included in the family scheme income of that person.

STATEMENT TO EMPLOYEES ON SHORT-TERM CHARGE FACILITIES PROVIDED

(Clause 67B)

Summary of proposed amendments

Employers who provide short-term charge facilities to employees will be required to provide employees with a statement about those short-term charge facilities.

Key features

Including vouchers in social assistance

As a result of another provision (clause 39B), employees will be required to include short-term charge facilities in their calculation of family scheme income for social assistance purposes if the value of the short-term charge facility is over the threshold. To assist employees in completing their income calculations for social assistance purposes, employers will be required to provide employees with information on the short-term charge facilities they provide to their employees. This is because employees are unlikely to keep records of all short-term charge facilities which they receive in a year. Because employers are required to pay FBT on these facilities if their value exceeds the threshold, they should have those records.

Consideration was given to only requiring employers to provide statements to employees when the employer knew the threshold had been exceeded. This approach was considered to be impractical, given that an employee could receive short-term charge facilities from more than one employer during the tax year.

Therefore, proposed section 46F of the Tax Administration Act 1994 requires all employers who provide short-term charge facilities to employees to provide those employees with a statement about those short-term charge facilities.

The statement will need to set out the threshold amount, which if breached, would result in the employee needing to include the short-term charge facilities received in their family scheme income.

The statement will also need to set out the value of all benefits received from the employer from short-term charge facilities in that income year. That value should not include the amount of fringe benefit tax which the employer may have paid. If this number exceeds the threshold, then the employee will be required to include the total value of benefits they have received from short-term charge facilities (this time including the fringe benefit tax) in their family scheme income. Accordingly, the statement is therefore also required to set out the total value of benefits, including the FBT paid.

The statement should also set out details of each short-term charge facility provided to the employee.

An employee who receives vouchers from more than one employer during the tax year will need to aggregate their benefits when carrying out the above comparison.

Example

Matt works for two employers, Company A and Company B, and earns $40,000 a year. They give Matt short-term charge facilities worth $700 and $650 respectively. Company A and Company B will each have to send Matt a statement about the short-term charge facilities they have given him.

Background

The amendment assists all employees receiving vouchers to determine whether they need to include them in their family scheme income. The requirement to include vouchers (above the minimum threshold) is part of a general widening of the definition of "family scheme income" aimed at providing greater equity between those employees who receive only salary and wages and those who receive some non-cash remuneration. Vouchers that cover everyday living expenses provide a readily substitutable alternative to salary and wages.

CONTRIBUTIONS PAID BY EMPLOYEES

(Clause 44F)

Summary of proposed amendment

This clause amends section RD 54(2) so that a fringe benefit with a negative value cannot arise.

Key features

Section RD 54(2) sets out that if an employee pays an amount for receiving a fringe benefit, the value of the benefit is reduced by the amount paid. This amendment ensures that the net value of the benefit cannot be a negative number.

Lease inducement payments and lease surrender payments

OVERVIEW

An officials' issues paper, *The taxation of lease inducement payments*, was released in July 2012, seeking feedback on proposals to tax lease inducement payments.

Lease inducement payments are unconditional lump sum cash payments generally made by landlords to induce tenants to enter into a commercial lease. For income tax purposes, these payments are typically non-taxable to a recipient (tenant) and deductible to a payer (commercial landlord). The risk identified in the issues paper was the tax asymmetry, which created an opportunity for taxpayers to substitute tax deductible rent payments with non-taxable cash lease inducement payments.

Following public consultation, the Government decided to tax lease inducement payments. However, the scope of the reform was extended to include another type of lease-related payment – lease surrender payments. For income tax purposes, lease surrender payments that are generally made by tenants to landlords to surrender existing lease arrangements are typically taxable to the recipient (commercial landlord) and non-deductible to the payer (tenant). These payments are currently regarded as "black hole" expenditure to the commercial tenant – that is, non-deductible business expenditure.

Measures introduced in this Supplementary Order Paper treat lease inducement payments and lease surrender payments as taxable to the recipient and tax deductible expenditure for the payer under the Income Tax Act 2007 from 1 April 2013. Generally, income and expenditure derived or incurred from these payments will be spread over the term of a lease.

The proposed measures are designed to improve fairness and business efficiency by removing existing tax treatments that distort business decisions such as non-taxable lease inducement payments and non-deductible lease surrender payments.

There will be a further review on the tax treatment of other commercial land-related lease payments, such as lease transfer payments. This review will consider the general tax treatment of commercial land-related lease payments, with a view to achieving a coherent and consistent tax treatment of these payments. It is expected that an officials' issues paper will be released for public consultation early next year seeking feedback on the review.

THE TAX TREATMENT OF LEASE INDUCEMENT PAYMENTS AND LEASE SURRENDER PAYMENTS

(Clauses 4B, 17B, 25B, 32B and 57(19B))

Summary of proposed amendments

Measures introduced in this Supplementary Order Paper modify the capital-revenue boundary for two specific land-related payments, namely lease inducement payments and lease surrender payments. Lease inducement payments are unconditional lump sum cash payments generally made by landlords to induce tenants to enter into a commercial lease. Lease surrender payments are generally made by tenants to landlords to surrender existing lease arrangements.

From 1 April 2013, these payments will be treated as taxable to the recipient and deductible to the payer under the Income Tax Act 2007.

Application date

The reform will apply to an amount that is:

- derived or incurred from 1 April 2013; and
- not derived or incurred as consideration for the agreement, before 1 April 2013, to a lease of land or a licence to use land.

The income tax treatment of an amount derived or incurred as consideration for the agreement before 1 April 2013 to a lease of land or a licence to use land will continue to be determined under general principles and provisions in the Income Tax Act 2007.

Key features

There are two main groups of amendments. The first group includes amendments relating to the tax treatment of lease inducement payments, namely the charging provision (new section CC 1B), the deduction provision (new section DB 20B), and the timing provision (new section EI 4B). The second group includes amendments relating to the tax treatment of lease surrender payments, namely the charging provision (new section CC 1C) and the deduction provision (new section DB 20C).

Under the amendments relating to lease inducement payments:

- If a person (the payee) derives an amount as consideration for the agreement by the payee to the grant, renewal, extension, or transfer of a right (the land right) that is a leasehold estate or a licence to use land, the amount will be taxable to the payee. An amount derived by a tenant of residential premises will be specifically excluded from the charging provision (new section CC 1B).

- A matching deduction provision will be provided. If a person (the payer) incurs an amount of expenditure as consideration for the agreement by another person (the payee) to the grant, renewal, extension, or transfer of a right (the land right) that is a leasehold estate or a licence to use land, the payer will be allowed a deduction for the amount (new section DB 20B).
- A new timing rule will allocate the income and deductions from a lease inducement payment evenly over the term of the land right to which the payment relates. An exception will apply when the person ceases to hold the relevant land right, or the estate in land from which the land right is granted, during an income year. For income, the remaining amount to be spread under the general timing rule will be allocated to that income year. For deductions, the remaining amount to be spread will be allocated to that income year if the land right, and the estate in land from which the land right is granted, are not held by the person or an associated person (new section EI 4B).

Under the amendments relating to lease surrender payments:

- If a person (the payee) derives an amount as consideration for the agreement by the payee to the surrender of a leasehold estate or the termination of a licence to use land, the amount will be taxable to the payee. An amount derived by a tenant of residential premises will be specifically excluded from the charging provision (new section CC 1C).
- A matching deduction provision will be provided. If a person (the payer) incurs an amount of expenditure as consideration for the agreement by another person (the payee) to the surrender of a leasehold estate or the termination of a licence to use land, the payer will be allowed a deduction for the amount (new section DB 20C).
- There is no specific timing rule for lease surrender payments. The general principles and provisions of the Income Tax Act 2007 will apply to determine the timing of income and deductions for lease surrender payments. Generally, income and deductions arising from lease surrender payments will be allocated to the income year in which the amount is derived or incurred.

Background

In July 2012, an officials' issues paper, *The taxation of lease inducement payments*, was released which proposed to address the revenue risk posed by lease inducement payments by making them taxable.

Lease inducement payments are unconditional lump sum cash payments generally paid by landlords to tenants as an inducement to enter into a commercial lease. For the recipient, the payment is generally a non-taxable capital receipt because the payment is received in relation to a lease that relates to the structure of the tenant's business. The capital nature of a lease inducement payment was confirmed by the Privy Council in *Wattie*.[1] For the payer, the payment is generally tax deductible if the payer incurs the expenditure in the course of carrying on a business of leasing.

[1] *Commissioner of Inland Revenue v Wattie* [1999] 1 NZLR 529.

The revenue risk identified in the issues paper was the deductible and non-taxable tax treatment of lease inducement payments in a commercial context. This created an opportunity for taxpayers to substitute tax deductible rent payments with non-taxable cash lease inducement payments. Also, compared with other forms of lease inducements such as a rent-free holiday or a contribution for fit-out costs, these payments provided a tax advantage which distorted business decisions on leases.

Example

A commercial landlord with premises that are used to generate $100,000 of rental income a year during an economic upturn would struggle to do so in a downturn. To induce a tenant to enter into a lease, the landlord could either reduce the rent from $100,000 to $60,000 or offer a lease inducement payment of $40,000 while maintaining the rent of $100,000.

Under the latter arrangement, the landlord receives the same amount of after-tax income of $43,200 ($100,000 minus $40,000 lease inducement resulting in taxable income of $60,000 less income tax at 28%). The tenant receives the tax advantage as they do not pay income tax on the amount of lease inducement of $40,000, while claiming a tax deduction for rental income expenses of $100,000 against their income. The tenant is $11,200 (tax cash value of non-taxable lease inducement payment of $40,000 at 28%) better off than simply paying the rent of $60,000. The deduction of $40,000 extra rent shelters income of the same amount.

Following public consultation, the Government decided to tax lease inducement payments as a base-protection measure. However, the scope of the reform was extended to address another existing asymmetry in the tax system that is "taxpayer-unfriendly" – the non-deductibility of lease surrender payments.

Lease surrender payments are generally made by tenants to landlords to surrender existing lease arrangements.[2] Lease surrender payments are typically taxable to the landlord recipient if they are in the business of leasing, but non-deductible to the tenant payer if the lease premises relate to the structure of the tenant's business; the latter treatment has been confirmed by the Court of Appeal in *McKenzies*.[3] These payments are currently regarded as "black hole" expenditure to the commercial tenant – that is, non-deductible business expenditure.

This reform is limited in scope by addressing existing tax asymmetries relating only to lease inducement payments and lease surrender payments. However, there are other existing tax asymmetries in the tax system in relation to other land-related lease payments such as lease transfer payments. Currently, lease transfer payments are generally non-taxable to the commercial tenant recipient and deductible to the incoming commercial tenant under the depreciation rules.

[2] Note that lease surrender payments can also be made by the landlord to secure the surrender of existing leases by tenants.
[3] *Commissioner of Inland Revenue v McKenzies New Zealand Limited* [1988] 2 NZLR 736.

Following the limited reforms included in this Supplementary Order Paper, there will be a further review of the taxation of other commercial lease-related payments. The objective of the review is to provide a consistent and coherent tax treatment of all commercial land-related lease payments that is consistent with the broad-base, low-rate tax framework. It is expected that an officials' issues paper will be released for public consultation early next year seeking feedback on the review.

Detailed analysis

The tax treatment of lease inducement payments

Income

New section CC 1B provides that if a person (the payee) derives an amount as a consideration for the agreement by the payee to the grant, renewal, extension or transfer of a land right, the amount will be taxable to the payee. The land right must be a right that is a leasehold estate or a licence to use land.

The charging provision will not apply to an amount derived in relation to a freehold estate in land, such as the proceeds from the sale of land. However, the charging provision will apply broadly to include amounts derived in relation to leases, including subleases, and other estates or interests in land. The term "leasehold estate" is defined in section YA 1 to include any estate, however created, other than a freehold estate.

An exception applies for residential tenants. A lease inducement payment is not income of the payee to the extent that the payee derives the amount as a tenant of residential premises. If there is a concurrent use of the land right for residential and business purposes, the amount will be apportioned so that only the amount relating to the business use is taxable (subsection (4)).

The charging provision will apply broadly to include amounts derived in relation to the entry into an agreement for the grant, renewal, extension or a transfer of the land right. For example, the provision will apply to an amount paid by a grantor of the land right (landlord) to induce a grantee (tenant) to agree to the grant, renewal or extension of a lease. Also, an amount paid by an assignor to induce an assignee to receive an assignment of a lease will be covered by the provision. Note that the transfer of the affected land right would include both registered and unregistered transfers.

The charging provision will not apply to an amount derived by the payee as the holder of a land right and as consideration for the transfer of the land right to the person paying the amount. This will exclude an amount paid by an assignee to an assignor for the transfer of an existing lease from the charging provision (subsection (2)).

The charging provision will apply to any person who derives the amount in relation to the land right. If a person receives a lease inducement payment on behalf of another person, the existing nominee rules in section YB 21 will apply to treat the amount as derived by that other person.

The reference to "amount" in section CC 1B uses the definition of "amount" in section YA 1, which includes any amount in money's worth. The charging provision therefore includes consideration other than cash.

Deductions

A matching deduction provision will provide symmetry in the tax treatment of lease inducement payments. New section DB 20B provides that lease inducement payments are deductible to a person (the payer) if the following conditions are met:

- the payer incurs an amount of expenditure as consideration for the agreement by another person (the payee) to the grant, renewal, extension or transfer of a right (the land right) that is a leasehold estate or a licence to use land;
- the payer is the person who owns the land right or the estate in land from which the land right is granted; and
- the payee is the person who is obtaining the land right.

Note that this deduction provision will cover other lease inducements, in particular, contributions for fit-out costs. A consequence of this is that the timing rule for deductions in new section EI 4B (discussed below) will apply to such other lease inducements.

New section DB 20B overrides the capital limitation in section DA 2(1). The general permission in section DA 1 must still be satisfied and the other general limitations in section DA 2 will still apply.

Timing of income and deductions

New section EI 4B is a timing provision for lease inducement payments. The timing provision will allocate the amount of income under section CC 1B or deductions under section DB 20B from a lease inducement payment evenly over the term of the land right (that is, a leasehold estate or a licence to use land) to which the amount of income or deductions relates (the spreading period).

The spreading period is the period after which a land right may be terminated, or expires, if not extended or renewed, that begins with the commencement, or the most recent renewal or extension, of the land right.

The timing provision will spread the amount derived or incurred before the end of the spreading period evenly over the spreading period. Given lease inducement payments are generally made at the commencement of the land right, the amount will be spread evenly over the relevant land right. Even when the amount is derived or incurred before the commencement of the land right, the amount will be allocated in relation to the spreading period, not when the amount is incurred or derived.

Example

On 1 April 2013, a tenant receives $100,000 from a landlord as consideration for the agreement to enter into a 10-year lease that commences on the same day. The tenant and the landlord both have a 31 March balance date.

The tenant

Under section CC 1B, $100,000 is taxable to the tenant. Under section EI 4B, the income is spread evenly over the 10-year period from the 2013–14 to the 2022–23 income years inclusive (i.e. $10,000 income is allocated to the tenant in each income year).

The landlord

Under section DB 20B, $100,000 is deductible for the landlord. Under section EI 4B, the deductions are spread evenly over the 10-year period from the 2013–14 to the 2022–23 income years inclusive (i.e. a deduction of $10,000 is allocated to the landlord in each income year).

The timing of income and deductions under section EI 4B is affected by when the income or expenditure is derived or incurred. For example, if the amount is derived or incurred half-way through the spreading period, the amount will be spread evenly over the remaining period. If the amount is derived or incurred at or after the end of the spreading period, the amount will be allocated to the income year in which it is incurred or derived.

Note that, under the timing provision, an amount of expenditure incurred by an assignor to induce an assignee to receive an assignment of a lease would be allocated to the income year in which the amount is incurred. By assigning the lease, the assignor has no remaining period over which to spread the expenditure. On the other hand, the assignee would spread the amount of income evenly over the remaining period of the lease.

If the spreading period is more than 50 years, the amount is allocated evenly over the first 50 years of the spreading period.

The timing provision will not apply to an amount that is income under section CC 1 or CG 8, which relates to income from land or capital contributions respectively. Income under section CC 1 would be taxable when derived unless section EI 7 applies. Income under section CG 8 would be spread evenly over 10 years unless the payee chooses to reduce the cost base of the depreciable property under section DB 64.

An exception applies to this new timing rule if the person ceases to hold the relevant land right, or the estate in land from which the land right is granted. There will generally be a "wash-up" calculation of income and deductions if a person ceases to hold the land right or the estate in land from which the land right is granted, part-way through the spreading period (subsections (4) and (5)).

For income, if there is a remaining amount to be allocated under the main spreading provision in section EI 4B(3), the amount of income will be allocated to an income year (the balance year) ending before the end of the spreading period, if –

- at the beginning of the balance year, the person holds the land right or the estate in land from which the land right is granted; and
- in the balance year, the person ceases to hold the land right or the estate in land from which the land right is granted (subsection (4)).

Example

On 1 April 2013, a landlord pays a tenant $100,000 as an inducement to enter into a 10-year lease. On 6 June 2016, the tenant transfers the lease to a new tenant. Both the landlord and the tenant have a balance date of 31 March.

The $100,000 payment is taxable to the tenant under section CC 1B and deductible to the landlord under section DB 20B.

The timing of income for the tenant under section EI 4B(4) is illustrated in the table below:

Income year	**Tenant**	
	Deduction	Income
2013–14	–	$10,000
2014–15	–	$10,000
2015–16	–	$10,000
2016–17	–	$70,000
2017–18	–	–
2018–19	–	–
2019–20	–	–
2020–21	–	–
2021–22	–	–
2022–23	–	–

The landlord continues to allocate the $100,000 deduction under the main spreading provision in section EI 4B(3).

For deductions, if there is a remaining amount to be allocated under the main spreading provision in section EI 4B(3), the amount of deductions will be allocated to an income year (the balance year) ending before the end of the spreading period if –

- at the beginning of the balance year, either or both the land right and the estate in land from which the land right is granted are held by the person or an associated person; and
- at the end of the balance year, neither of the land right and the estate in land from which the land right is granted are held by the person or an associated person (subsection (5)).

Note that if the land right or the estate in land from which the land right is granted is transferred to an associated person, there will be no "wash-up" calculation for deductions. The remaining amount of deductions will continue to be allocated over the spreading period under section EI 4B(3). This is intended as an anti-avoidance measure to prevent the timing of deductions being accelerated by transferring the land right or the estate in land from which the land right is granted to an associated person. The general anti-avoidance provision in section BG 1 will also apply to counter any tax-driven transactions that attempt to exploit the new timing provision contrary to the policy intent.

The definition of "land provision" in section YA 1 is being amended so that the definition of "associated person" applying in section EI 4B is the version applicable to land provisions.

Example

On 1 April 2013, a landlord pays a tenant $100,000 as an inducement to enter into a 10-year lease. On 6 June 2016, the landlord sells the freehold estate to an unassociated third party for $3,000,000. Both the landlord and the tenant have a balance date of 31 March.

The $100,000 payment is taxable to the tenant under section CC 1B and deductible to the landlord under section DB 20B.

The timing of deductions for the landlord under section EI 4B(5) is illustrated in the table below:

Income year	**Landlord**	
	Deduction	Income
2013–14	$10,000	–
2014–15	$10,000	–
2015–16	$10,000	–
2016–17	$70,000	–
2017–18	–	–
2018–19	–	–
2019–20	–	–
2020–21	–	–
2021–22	–	–
2022–23	–	–

If the landlord had transferred the land to their spouse, the landlord would continue to allocate $10,000 of deductions to each income year until the 2022–23 income year.

The tenant continues to allocate the $100,000 amount of income under the main spreading provision in section EI 4B(3).

To prevent overlap, section EA 3, which relates to the timing of prepayments, is being amended to exclude any amounts subject to this timing provision.

The tax treatment of lease surrender payments

Income

New section CC 1C provides that if a person (the payee) derives an amount as a consideration for the agreement by the payee to the surrender of a leasehold estate or the termination of a licence to use land, the amount will be taxable to the payee. The payee must be one of the following:

- the person who owns the estate in land from which the leasehold estate or licence is granted; and/or
- the person who owns the leasehold estate or licence.

In most cases, lease surrender payments will be made by a tenant to a landlord to surrender an existing lease. However, the charging provision will also apply if the payment is made by the landlord to the tenant for them to surrender an existing lease. The existing nominee rules in section YB 21 will apply if a person acts on behalf of the payee.

The charging provision will not apply to an amount derived in relation to a freehold estate in land, such as the proceeds from the sale of land. However, the charging provision will apply broadly to include amounts derived in relation to leases, including subleases and other estates or interests in land. The term “leasehold estate” is defined in section YA 1 to include any estate, however created, other than a freehold estate.

An exception applies for residential tenants. A lease surrender payment will not be income of the payee to the extent that the payee derives the amount as a tenant of residential premises. If there is a concurrent use of the land right for residential and business purposes, the amount will be apportioned so that only the amount relating to the business use is taxable (subsection (3)).

Deductions

A matching deduction provision will provide symmetry in the tax treatment of lease surrender payments. New section DB 20C provides that lease inducement payments will be deductible to a person (the payer) if the following conditions are met:

- the payer incurs an amount of expenditure as consideration for the agreement by another person (the payee) to the surrender of a leasehold estate or the termination of a licence to use land;
- the payer is a person who owns the leasehold estate or licence, or the estate in land from which the leasehold estate or licence is granted; and
- the payee is a person who owns the leasehold estate or licence, or the estate in land from which the leasehold estate or licence is granted.

Section DB 20C overrides the capital limitation in section DA 2(1). The general permission in section DA 1 must still be satisfied and the other general limitations in section DA 2 will still apply.

Timing of income and deductions

No specific timing provision is provided for lease surrender payments. The timing of the amount derived or incurred under sections CC 1C and DB 20C will, therefore, be determined under the general provisions of the Income Tax Act 2007.

Generally, income and deductions for lease surrender payments will be allocated to the income year in which the amount is derived or incurred. This is considered appropriate for lease surrender payments as there would normally be no remaining period of the land right over which the amount can be spread at the time the lease surrender payments are derived or incurred.

Other policy matters

TREATMENT OF SHORT-TERM AGREEMENTS FOR SALE AND PURCHASE UNDER THE FINANCIAL ARRANGEMENTS RULES

(Clause 33B)

Summary of proposed amendment

New section EW 32B adjusts the amount of consideration (payment) that a vendor or purchaser of a short-term agreement for sale and purchase may take into account for the purposes of applying the financial arrangements rules, if they elect to treat the agreement as a financial arrangement.

This means the taxpayer will not be able to claim a deduction under the financial arrangements rules for amounts that are payments for capital or goodwill – for example, the cost of acquiring a contract to provide services or any losses on disposal of such a contract.

Application date

The amendment will apply for a short-term agreement for sale and purchase that a taxpayer elects to treat as a financial arrangement unless the election occurs before 27 September 2012 or the taxpayer has obtained a binding ruling or determination on the tax treatment of the agreement under subpart EW before 27 September 2012.

Key features

An amendment is being made to adjust the amount of consideration that a vendor or purchaser of a short-term agreement for sale and purchase may take into account for the purposes of applying the financial arrangements rules, if they elect to treat the agreement as a financial arrangement.

The amount of consideration that can be taken into account for spreading or undertaking a base price calculation will be limited to debts outstanding under the short-term agreement for sale and purchase. This means taxpayers will not be able to claim a deduction under the financial arrangements rules for either the cost of acquiring the agreement or any losses on disposal of the agreement.

Background

The purpose behind the financial arrangements rules in the Income Tax Act is to account for the income or expenditure on a financial arrangement (the "interest" component) over the term of the arrangement.

The problem under the current financial arrangements rules is that it is possible for taxpayers to receive a deduction for the goodwill component of certain contracts when they are purchased. The rules also allow a deduction for a loss on the sale of onerous contracts.

The manner in which this can be achieved is through electing to treat a short-term agreement for sale and purchase (ordinarily, an excepted financial arrangement under section EW 5(22)) as a financial arrangement under section EW 8.

The following example illustrates the problem:

A company acquires the assets of another company, which includes profitable contracts for the provision of certain future services. The purchase price for the contracts is $5 million, being the present value of estimated future profits from providing services under the contract. Electing that the service contracts be financial arrangements and then applying the financial arrangements rules, a tax deduction of $5 million is available to the purchaser over the life of the contracts, resulting in tax savings of $1.4 million. If the contracts were treated as excepted financial arrangements (as conceptually they should be) the general deductibility rules would treat the amounts as capital (non-deductible) expenditure, just as the sale proceeds to the vendor would usually be capital and therefore non-taxable.

The rationale behind allowing a taxpayer to elect to treat a short-term agreement for sale and purchase as a financial arrangement was to reduce compliance costs by allowing any short-term debt under the agreement to be treated for tax purposes as it is for accounting purposes. The rule was never intended to allow taxpayers to convert what would otherwise be capital sums into deductible amounts.

Accordingly, it is proposed that an amendment be made to the financial arrangements rules to prevent this outcome.

(Clauses 12B, 34B, 57(1B), 57(19C)-(19D), 57(23B), 57(25B-25E), 57B, 74(2)-(3) and 94B)

Summary of proposed amendments

In June 2012 the KiwiRail group announced a restructure of its balance sheet, to reflect a standard commercial valuation approach. Under the new structure, a new state owned enterprise will own and operate the rail and Interislander businesses under the existing KiwiRail brand. Crown land held for rail purposes will be retained by the New Zealand Railways Corporation and made available for use by KiwiRail.

Supplementary Order Paper No. 167 contains several technical amendments to support this restructure, to ensure that the restructure does not impose additional tax liabilities, and to provide for the tax position of the new State Owned Enterprise going forward.

Application date

The amendments will apply from 31 December 2012, being the date of the restructure.

Remedial matters

DEDUCTIBILITY OF DEPRECIABLE INTANGIBLE PROPERTY LISTED IN SCHEDULE 14

(Clauses 31B and 105B)

Summary of proposed amendment

Supplementary Order Paper No. 167 amends section EE 7 of the Income Tax Act 2007 and the Income Tax Act 2004 to clarify that depreciable intangible property listed in schedules 14 and 17 of the Acts (respectively) is deductible under the depreciation rules.

Application date

The amendment to section EE 7 of the Income Tax Act 2007 will apply from 1 April 2008.

The amendment to section EE 7 of the Income Tax Act 2004 will apply from 1 April 2005.

Key features

The exclusions for land and excepted financial arrangements from the definition of "depreciable property" in section EE 7 are to be amended. The purpose is to clarify that depreciable intangible property listed in schedule 14 of the 2007 Act and schedule 17 of the 2004 Act remains deductible under the depreciation rules.

Background

There is currently some uncertainty over whether certain depreciable intangible property listed in schedule 14 of the 2007 Act and schedule 17 of the 2004 Act is deductible under the depreciation rules. This is a result of a series of changes to the tax legislation since 1993, which is when certain intangible property such as "the right to use land" became deductible under the depreciation rules.

In particular, the uncertainty arises from the exclusion of excepted financial arrangements from the definition of "depreciable property" in section EE 7(e). This exclusion was introduced by the 2004 Act.

Leases are excepted financial arrangements under section EW 5(9) of the 2007 Act and the term "lease" is widely defined in the financial arrangements rules to include leases or licences of land, and licences to use intangible property. Consequentially, most depreciable intangible property listed in schedules 14 and 17 of the 2007 and 2004 Acts (respectively) would be excepted financial arrangements and could be excluded from being depreciable property for deduction purposes.

Also, the specific exclusion of land from the definition of “depreciable property” in section EE 7(a) of the 2007 Act creates uncertainty over whether the “right to use land” listed in schedule 14 is deductible under the depreciation rules. This is a result of adopting a generic definition of “land”, which includes leases and licences of land, as part of the rewrite of the Income Tax Act 2004.

MINOR TECHNICAL AMENDMENTS

Supplementary Order Paper No. 167 proposes a number of drafting remedial changes. Many of them are minor changes to cross-references and readers' aids, but the majority are amendments to remove redundant references to loss-attributing qualifying companies (LAQCs). The LAQC rules have been replaced by look-through company rules.