

31 January 2014

Public Consultation  
Inland Revenue Department  
PO Box 2198  
WELLINGTON 6140

### **INS0123: Income Tax – Consumable Aids**

1. The Law Society appreciates the opportunity to comment on the draft Interpretation Statement *INS0123: Income tax: consumable aids* (Statement).
2. The New Zealand Law Society (Law Society) makes a limited number of comments relating to:
  - (a) the distinction drawn in the Statement between “consumable aids” and “spare parts”; and
  - (b) the clarity of the explanation given in the Statement of the operation of and relationship between sections EA 3 and DB 50 of the Income Tax Act 2007.
3. The Statement also highlights some unsatisfactory outcomes produced by the criteria for the application of Determination E12 (DET E12). While not directly relating to the Statement, the Law Society has taken the opportunity to comment on these outcomes in case the Department wishes to address them from a policy perspective.

### **Consumable aids, raw materials and spare parts**

4. The Statement draws a distinction between consumable aids and spare parts, in paragraphs 15 – 18.
5. It includes the statement, at paragraph 15, that “consumable aids are distinguishable from raw materials and spare parts”. Spare parts are subsequently defined in paragraph 17, with the Statement distinguishing them from consumable aids on the grounds that they “are not used in the day-to-day running of manufacturing process”, instead being used sporadically for repairs. This is presumably to contrast with the requirement for a consumable aid to be consumed at a rapid rate or to become unusable or worthless once applied. This leads to the Statement’s conclusion later in that paragraph that spare parts would not be able to obtain the benefit of DET E12.
6. The Law Society submits that a distinction between consumable aids and spare parts is potentially problematic and unnecessary. Nothing in DET E12 specifically excludes spare parts from its ambit. Likewise, the case law outlined in the Statement does not attempt to define spare parts nor to

distinguish them from consumable aids. If a spare part is ostensibly called a spare part, but is used with such frequency as to meet the definition of a consumable aid, no legal distinction prevents it from being treated as a consumable aid under DET E12. While a spare part may not usually have the characteristics of a consumable aid, the two concepts are not mutually exclusive in a definitional sense. The correct focus is on the characteristics of a consumable aid and not any distinction between consumable aids and spare parts.

- 7 The Law Society recommends that the distinction drawn in paragraph 17 of the Statement between a spare part and a consumable aid should be reconsidered.

#### **Application of sections EA 3 and DB 50**

8. The Statement describes the rules relating to when the unexpired portion of expenditure on consumable aids is income or deductible expenditure across income years.
9. Where section EA 3 requires that unexpired portions of expenditure allowed as deductions be added back as income, paragraph 21 states that – so long as it is used or “not still unexpired” – in the subsequent year that amount can be added back as a deduction, under section EA 3(3)(b). That paragraph also states that under section DB 50 “that unexpired portion” is deductible in the following income year so long as section EA 3 does not continue to apply.
10. These explanations appear to be incompatible with the intended operation of sections EA 3(3)(b) and DB 50, neither of which impose requirements that the portion of expenditure declared as income in one year must be used in order to qualify for a deduction in the following year. Section DB 50 allows an automatic deduction for the portion of expenditure treated as income in the prior year, regardless of it being expired or not. Section EA 3 may require the recognition of income if the expenditure remains unexpired at year end to achieve spreading but its application is independent.
11. The approach described in the Statement could result in the over-recognition of income if only the expired portion is permitted as a deduction but section EA 3 operates each year to create an amount of income equal to the unexpired portion.
12. The Law Society recommends that the description of the application of sections EA 3 and DB 50 across income years should be clarified.

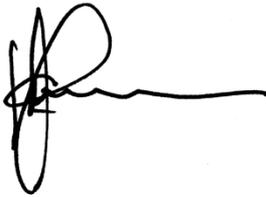
#### **Examples of Determination E12 application**

13. The examples at the conclusion of the Statement appear correct but highlight a potential issue with certain outcomes under DET E12 that the Department may wish to consider from a policy perspective.
14. In particular, the reason underlying the requirement in Paragraph 4(d) that the “goods are in the possession of the person at balance date” is difficult to intuit.
15. Example 5 highlights the issue. Goods which have been paid for but for administrative or other reasons not yet delivered cannot be brought within the exception and are subject to section EA 3. No reason for such a rule is evident, and the potential for such an outcome to occur for reasons beyond the taxpayer’s control is obvious.

**Conclusion**

16. This submission was prepared with assistance from the Law Society's Tax Law Committee. If you wish to discuss this further please do not hesitate to contact the committee convenor Neil Russ, through the committee secretary Rhyn Visser (04 463 2962, [rhyn.visser@lawsociety.org.nz](mailto:rhyn.visser@lawsociety.org.nz)).

Yours sincerely

A handwritten signature in black ink, appearing to be 'Chris Moore', with a long horizontal line extending to the right.

Chris Moore  
**President**