

18 May 2018

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Dear Matthew

Income Tax – Treatment of Costs of Resource Consents – Draft Interpretation Statement

Introduction

1. Thank you for giving the New Zealand Law Society's Tax Law Committee the opportunity to comment on the draft Interpretation Statement: *Income Tax – Treatment of Costs of Resource Consents* (draft IS). We note that the draft IS has been provided on a confidential basis in order to test Inland Revenue's conclusions and approach, before it is published for full external consultation. You have asked in particular for feedback about the draft's usefulness in practice and whether any common examples might be missing.
2. The draft IS has been considered by the Law Society's Tax Law Committee and comments are set out below.

Format

3. Comments on the substance of the draft IS are set out below. We thought it would also be useful to make some practical observations about the document's format.
4. Some members noted that if this guidance is required, it could be provided in a more direct and less complicated way. For example, the draft IS is very long: at 46 pages, it may be a little impenetrable for taxpayers who will also have to consider IS 17/01 (at 41 pages) to ascertain the correct treatment.
5. The flowcharts are helpful but cannot be relied on in isolation. Recourse to the text is necessary to understand them and identify exceptions. We suggest it may be helpful to include them as appendices, rather than in the body of the draft IS.
6. It may be helpful to have more examples, especially relating to land consents. Also, it is unclear why Examples 8 – 11 are at the end of the draft IS and not alongside the relevant tracts of guidance as other examples are.

Substantive issues

7. The draft IS indicates that there is limited scope for deductions for feasibility expenditure in a resource consent context. This appears to be at odds with the Supreme Court's decision in *Trustpower v CIR* [2016] NZSC 91, which said (at paragraph 72) that "We are, however, also of

the view that expenditure associated with early stage feasibility assessments may be deductible”.

8. The discussion about cost base is not sufficiently precise to give taxpayers the certainty they will require in order to take a tax position. It uses words such as “will generally”, “could” and “may”. Although there is a list of examples of expenditure on a resource consent, those examples are expressed as expenses that *could* form the depreciable cost base of a resource consent. Taxpayers need to know what *can* and *cannot* be included. (For example, the draft IS lists “appeal costs” as expenses of resource consents – but it is unclear to what extent they are “costs”.) With this in mind, it would also be helpful to have a list of examples of costs that would be *ineligible* for inclusion in the cost base.
9. The draft IS states at paragraphs 16 and 81 that *Trustpower* provides authority for the proposition that resource consent expenditure is usually on capital account. That is not correct. The Supreme Court did acknowledge the explanatory material and the legislation suggested that (see paragraphs 29 and 49), but it did not go so far as to make that conclusion itself. What the Court concluded was that the expenditure *in this case* was on capital account (see paragraph 71).
10. The draft IS acknowledges that *Trustpower* did not deal with the land consents point. However, the draft IS sets out in detail how expenditure on resource consents may be included in the cost base of another item of depreciable property. This approach is sensible.
11. Paragraphs 106 – 111 and Example 1 deal with when resource consent costs can be on revenue account. The draft IS deals with the position of land developers but does not address whether taxpayers caught by the bright-line or “intention to sell” provisions can also treat resource consent expenses as on revenue account.
12. It is not clear what the authority is for the proposition at paragraphs 124 – 147 that environmental consents are depreciated according to their legal life rather than the estimated life of any items to which they relate. The Supreme Court made no conclusion about whether consents were stand-alone assets. It would however seem that they can also be included in the cost base of another item of depreciable property.

Next steps

13. We hope you find these comments helpful. If you wish to discuss them further, please contact me via the committee secretary, Jo Holland (jo.holland@lawsociety.org.nz / 04 463 2967).
14. We look forward to hearing from you when the draft IS is released for full external consultation.

Yours sincerely



Neil Russ
Convenor, Tax Law Committee