



WEEKLY COMMENT: FRIDAY 14 MARCH 2014

1. The *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill* (“the November Bill”), which was introduced on 22 November 2013 contains a number of proposed amendments relating to the taxation of land-related lease payments. The Finance and Expenditure Committee is due to report back on the Bill by 10 June 2014.
2. Last week I looked at the amendments relating to lease transfer payments. This week I look at the other amendments proposed affecting the taxation of leases on land.
3. The topics covered this week are:
 - (a) Permanent easements;
 - (b) Perpetually renewable leases (“Glasgow leases”);
 - (c) Consecutive leases;
 - (d) Consecutive leases of personal property;
 - (e) Financial arrangements exclusion for consecutive leases clarified;
 - (f) Retirement village occupation rights excluded from being financial arrangements.

Permanent easements

4. Under s. CC 1 of the *Income Tax Act 2007*, an amount listed in s. CC 1(2) is income of the owner of land if they derive the amount from:
 - (a) A lease, licence, or easement affecting the land; or
 - (b) The grant of a right to take the profits of the land.
5. The listed amounts are:
 - (a) Rent;
 - (b) A fine;
 - (c) A premium;
 - (d) A payment for the goodwill of a business;
 - (e) A payment for the benefit of a statutory licence;
 - (f) A payment for the benefit of a statutory privilege; and
 - (g) Other revenues.

6. The insertion of a new s. CC 1(2B) is proposed in clause 8 of the November Bill, under which an amount will not be income of the owner of a fee simple estate in land if derived as consideration for the grant, for the duration of the estate, of an easement over the land.
7. The proposed amendment is to apply from 1 April 2015.
8. A payment for a permanent easement is currently taxable to a landowner under s. CC 1. Officials have stated in the *Commentary* that:

“The purpose of this specific exclusion is to align the tax treatment of a permanent easement (or a perpetual right of way) with that for freehold land under the existing s. CC 1.”
9. Officials have pointed out that the land provisions in ss. CB 6 to CB 23B will continue to apply to permanent easements.
10. A payment for a permanent easement will continue to be non-deductible to the payer. Currently, a payment for a permanent easement is non-deductible under the depreciation rules because a permanent easement does not meet the definition of depreciable property under s. EE 6. In normal circumstances, it is not reasonably expected to decline in value. This treatment will not change.

Perpetually renewable leases (“Glasgow leases”)

11. Section EE 7 lists property that is not depreciable property. Land is excluded from being depreciable property under s. EE 7(a).
12. The insertion of a new s. EE 7(ab) is proposed in clause 53 of the November Bill under which a lease of land with a perpetual right of renewal will not be depreciable property. The effect will be to treat a perpetually renewable lease similarly to freehold land for tax depreciation purposes. The amendment is to apply from 1 April 2015.
13. A perpetually renewable lease is explained as follows in the *Commentary*:

“Perpetually renewable leases last for a certain duration (for example, 7, 10 or 21 years), but are renewable in perpetuity at the option of tenants. They are commonly known as “Glasgow” leases. They are typically for the bare land only and tenants generally own the improvements on the land. Rents on these leases are reviewed periodically (usually to a market rate).”
14. Under current rules, such a lease is not excluded from being depreciable property and lease payments could be depreciable and/or a loss on disposal may be claimable, if the requirements for depreciable property are met:
 - (a) The lease is within the definition of depreciable intangible property; and
 - (b) It is property that, in normal circumstances, might reasonably be expected to decline in value while it is used or available for use in deriving assessable income or in carrying on a business for the purpose of deriving assessable income; and
 - (c) It is not listed in s. EE 7.
15. In most cases, a depreciation deduction may not be available over the term of the lease because of the perpetually renewable period, but a loss on disposal could be claimed under the current rules if the lease is sold for less than its adjusted tax value.

16. The proposed amendment will mean that no loss on disposal can be claimed under the depreciation rules when a perpetually renewable lease is sold.
17. The recipient of a payment for a perpetually renewable lease will continue to be taxed under s. CC 1. Officials note that such a payment (for example, a lease premium) is easily substitutable for taxable rent payments on a perpetually renewable lease that are periodically reset to market levels.

Consecutive leases

18. Officials are of the view that tax could be avoided through the use of consecutive leases which allow the timing of depreciation deductions for the cost of acquiring a lease (a lease premium or lease transfer payment) to be accelerated. In some circumstances, the general anti-avoidance rule in s. BG 1 could apply at present.
19. However, officials prefer to insert a specific rule as an additional anti-avoidance measure. Tax depreciation deductions for fixed life intangible property, such as a land lease, depend on the “legal life” of the intangible asset.
20. With effect from 1 April 2015, the definition of “legal life”, for tax depreciation purposes in s. EE 67, of a land right that is a leasehold estate or a licence to use land, is to be extended so as to include the number of years, months, and days for which the person or an associated person has an owner's interest in the land right, or in a consecutive or successive land right, under the contract or statute that creates the owner's interest, determined:
- (a) When the person acquires the owner's interest; and
 - (b) Assuming that the person or associated person exercises rights of renewal, extension, or further grant that are either essentially unconditional or conditional on the payment of predetermined fees.
21. The effect of the amendment will be that:
- (a) For consecutive leases over the same parcel of land, that are granted to a person or an associated person at the same time, the term of a lease will include the terms of consecutive leases owned by the person or the associate; but
 - (b) Consecutive leases would need to be acquired by the person or associated person at the same time to be counted towards the legal life of a lease; and
 - (c) Any genuinely subsequently negotiated leases or licences of land will not be counted towards the legal life of a lease.
22. An example is provided in the *Commentary* in which 3 associated persons A, B and C enter into 3 separate leases for the same parcel of land to take effect immediately after one terminates. Each lease lasts 10 years. Person A is treated as having entered into a lease for 30 years, person B for 20 years, and person C for 10 years.
23. The definition of “associated person” that will apply to s. EE 67 will be the definition that applies for the purposes of the land provisions, under an amendment proposed in clause 123(23) to the definition of “land provisions” in s. YA 1.

Consecutive leases of personal property

24. The definition of “lease” in s. YA 1 includes, in paragraph (d)(v), 2 or more consecutive leases of personal property that are treated as a single lease because the Commissioner regards them as 1 lease.
25. The discretion of the Commissioner to determine if consecutive leases of personal property are to be treated as a single lease is being removed. Paragraph (d)(v) of the definition of “lease” in s. YA 1 is to be amended to align the definition of a consecutive lease of personal property with the definition of a consecutive lease in s. EE 67. Officials have stated in the Commentary that this is in order to “provide certainty and consistency”.
26. Under the proposed new definition, an arrangement for the leasing of a personal property lease asset to a lessee or an associated person under 2 or more consecutive or successive leases will be treated as 1 lease, if the entitlement of the lessee or associated person to each consecutive or successive lease is, when the lessee enters the arrangement, essentially unconditional or conditional on the payment of predetermined fees.

Financial arrangements exclusion for consecutive leases clarified

27. Leases are excluded from the financial arrangements rules because they are excepted financial arrangements under s. EW 5(9). A “lease” for the purposes of the financial arrangements rules is defined in paragraph (f) of the definition of “lease” in s. YA 1.
28. Paragraph (f)(ii) is to be amended, to make it clear that a lease of land, livestock or bloodstock will be a “lease” for the purposes of the financial arrangements rules if it would be a lease under paragraph (d) of the definition of “lease if the property had been personal property.
29. The proposed change to the definition of consecutive leases discussed in paragraphs 24 onwards above will make it much clearer that such leases are excluded from being financial arrangements.

Retirement village occupation rights excluded from being financial arrangements

30. Retirement village occupation rights that are licences to occupy are currently regarded as financial arrangements because they are not a lease for the purposes of financial arrangement rules as defined in s. YA 1.
31. Officials have stated in the *Commentary* that:

“Treating certain retirement village occupation rights as financial arrangements is undesirable from a policy perspective. In particular, if certain retirement village occupation rights are subject to the financial arrangement rules, there may be tax consequences for a retirement village resident.

The existing financial arrangement rules shift financial benefits from the transaction from one party to another. Consequently, under certain retirement village occupation rights arrangements, deductions may be allowed to a retirement village operator and assessable income may arise to the resident. This tax outcome would not generally have been contemplated by the contracting parties at the time of the transaction.”

32. With effect from 1 April 2015, paragraph (f) of the “lease” definition in s. YA 1 is to be amended to include an occupation right agreement as defined in the *Retirement Villages Act*

2003. Therefore, retirement village occupation rights will be treated as an excepted financial arrangement in s. EW 5(9), and excluded from the financial arrangement rules.

33. It is noted in the *Commentary* that Determination S16, which was issued by the Commissioner of Inland Revenue in 2010, applies to certain retirement village occupation rights that are leases resulting in the financial arrangement rules not applying to such arrangements. However, officials prefer a legislative amendment to “provide greater certainty and ensure that all occupation right agreements under the *Retirement Villages Act 2003* are excluded from the financial arrangement rules”.



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