



## WEEKLY COMMENT: FRIDAY 18 JULY 2014

1. The *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014* ("the Employee Allowances Tax Amendment Act 2014 ") received the Royal assent on 30 June 2014. I commenced reviewing the amendments by looking at the changes affecting lease payments.
2. In the last 2 weeks I have looked at the amendments affecting lease inducements and lease surrender payments, including the spreading provisions. This week I look at the remaining specific changes affecting lease payments. All of the lease payments amendments are covered in detail, including the examples and explanations to date in *Tax Information Bulletin* Vol. 25 No. 9 October 2013 ("the TIB Item") in the attached PDF on *Lease Inducement, Lease Surrender and Lease Transfer Payments*.

### **Exemption for payments for permanent easements (other than periodic payments)**

3. Rents, fines, premiums and similar revenues derived by an owner of land from a lease, licence, or easement affecting the land or from the grant of rights to take profits of the land are taxable under s. CC 1. Officials were of the view that the tax treatment of a permanent easement (or a perpetual right of way) should be aligned with that for freehold land. Consequently, a new s. CC 1(2C) has been inserted, applying from 1 April 2015, that states:  
"An amount is not income of the owner of a fee simple estate in land if the amount is derived as consideration for the grant, for the duration of the estate, of an easement over the land and is not a periodic payment."
4. Additional points worth noting are:
  - (a) A payment for a permanent easement remains taxable to a landowner under s. CC 1 until 1 April 2015.
  - (b) The exemption will not apply to ongoing periodical payments for a permanent easement. Officials were of the view that such payments should be on revenue account.
  - (c) The land provisions in ss. CB 6 to CB 23B will continue to apply to permanent easements.
5. In terms of the corresponding tax treatment for the payer, officials' view is that 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. Officials have stated that no change to the current tax treatment is proposed. A payment for a permanent easement will continue to be non-deductible to the payer.

## **Perpetually renewable leases will not be depreciable property from 1 April 2015**

6. Section EE 7 lists property that is not depreciable property. Land is excluded from being depreciable property under s. EE 7(a). A new s. EE 7(ab) has been inserted, with effect from 1 April 2015, 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.
7. A perpetually renewable lease is explained as follows on page 88 of the *Commentary to the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill* (“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).”
8. 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 following 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.
9. Officials are concerned that although in most cases, a depreciation deduction may not be available over the term of the lease because of the perpetually renewable period, a loss on disposal could be claimed under the current rules if the lease is sold for less than its adjusted tax value.
10. The amendment will mean that, from 1 April 2015, no loss on disposal can be claimed under the depreciation rules when a perpetually renewable lease is sold.
11. The recipient of a payment for a perpetually renewable lease will continue to be taxed under s. CC 1. Officials noted 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.

## **A lease’s “legal life” will include the term of consecutive leases from 1 April 2015**

12. A lease term for tax depreciation purposes will be the accumulated term of consecutive leases from 1 April 2015. A new paragraph (d) extending the definition of “legal life” in s. EE 67 has been inserted, applying from 1 April 2015, that states:

For a person and a right (a **land right**) that is a leasehold estate, or a licence to use land, (legal life) means 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.
13. Officials referred to it as a specific additional anti-avoidance measure. It is worth noting that:
- (a) The amendment will apply to consecutive leases:
    - (i) Over the same parcel of land; and
    - (ii) Granted to persons including the person and associated persons at the same time.
  - (b) If the consecutive leases are not acquired at the same time, they will not be accumulated when determining the legal life of a lease.
  - (c) The amendment will not apply so as to treat any genuinely subsequently negotiated leases or licences of land as part of the initial legal life of a lease.
14. 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 in s. 144(24) of the Employee Allowances Tax Amendment Act 2014, to the definition of “land provisions” in s. YA 1.

#### **Consecutive leases of personal property**

15. 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.
16. 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 has been amended, effective from 1 April 2015, 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”.
17. Under the 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**

18. 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. Paragraph (f) of the definition of “lease” has been replaced, by s. 144(26) of the Employee Allowances Tax Amendment Act 2014, effective from 1 April 2015.
19. Paragraph (f)(i) has not itself been changed, and still states that a lease for the purposes of the financial arrangements rules is “a lease as described in paragraph (d) (of the definition of “lease”)). However, the amendment to consecutive leases in paragraph (d)(v) described in paragraphs 15-17 above will mean that such leases will be clearly excluded from being financial arrangements.

20. In addition, paragraph (f)(ii) of the definition of “lease” has been amended, effective from 1 April 2015, 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.

**Financial arrangements exclusion for retirement village occupation rights**

21. Retirement village occupation rights that are licences to occupy are currently regarded as financial arrangements because they are not leases for the purposes of financial arrangement rules as defined in s. YA 1. A new paragraph (f)(iii) has been inserted into the definition of “lease” in s. YA 1, effective from 1 April 2015, which states that a lease in the financial arrangements rules means:

“An occupation right agreement as defined in the *Retirement Villages Act 2003*”.

22. This amendment will mean that retirement village occupation rights will be treated as an excepted financial arrangement in s. EW 5(9), and excluded from the financial arrangement rules.

23. Officials 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.”

24. 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”.

25. As already noted, all of the lease payments amendments are covered in detail, including the examples and explanations to date in *Tax Information Bulletin* Vol. 25 No. 9 October 2013 (“the TIB Item”) in the attached PDF on *Lease Inducement, Lease Surrender and Lease Transfer Payments*.



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