



WEEKLY COMMENT: FRIDAY 25 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. This week I look at the amendments relating to black hole expenditure, other than the amendments relating to company administration costs.
2. On 22 July Inland Revenue released IS 14/04 *Income tax: Deductibility of company administration costs* and I will take the opportunity next week to comment on that as well as the black hole amendments relating to company administration costs.

Resource consents not obtained

3. Effective from the 2014-15 income year onwards, s. 43 of the Employee Allowances Tax Amendment Act 2014 has replaced s. DB 19, which now applies to “Expenses in application for resource consent” (as opposed to expenses only of failed or withdrawn applications). Replaced s. DB 19 applies to *a person who incurs expenditure for the purpose of applying for the grant* of a resource consent under the Resource Management Act 1991 (“RMA”) who:
 - (a) Does not obtain the grant because the application is not lodged or is withdrawn, or because the grant is refused; or
 - (b) Obtains the grant but does not use the resource consent before it lapses or is surrendered.
4. Officials agreed with submitters that the amendment to s. DB 19 should be extended to allow for situations where resource consents lapse or are surrendered. In such situations, capital expenditure will have been incurred on an unsuccessful resource consent. Allowing a deduction for expenditure incurred on lapsed or surrendered resource consents is consistent with the policy intent of removing “black hole” treatment for expenditure on unsuccessful resource consents.
5. A deduction is allowed for expenditure:
 - (a) That the person incurs in relation to the application or intended application; and
 - (b) That would have been part of the cost of depreciable property, or otherwise a deduction, if:
 - (i) The application or intended application had been granted; or
 - (ii) The resource consent had been used; and
 - (c) For which the person is not allowed a deduction under another provision.

6. The deduction in s. DB 19 must be allocated to the income year in which:
 - (a) The person decides not to lodge the application, withdraws the application, or is refused the grant; or
 - (b) The resource consent lapses or is surrendered.
7. The two key differences are that:
 - (a) A deduction will be allowed for an *intended application* that is abandoned, as opposed to an actual application; and
 - (b) A deduction will be allowed for a resource consent that is not used before it lapses or is surrendered.

Patent application not lodged or failed or withdrawn

8. Effective from the 2014-15 income year onwards, s. 47 of the Employee Allowances Tax Amendment Act 2014 has replaced s. DB 37, which now applies to “Expenses in application for patent” (as opposed to expenses only of failed or withdrawn patent applications). Under replaced s. DB 37 *a person who incurs expenditure for the purpose of applying for the grant of a patent and does not obtain the grant because the application is not lodged or is withdrawn, or because the grant is refused, is allowed a deduction for the expenditure:*
 - (a) That the person incurs in relation to the application or intended application; and
 - (b) That would have been part of the cost of depreciable property, or otherwise a deduction, if the application or intended application had been granted; and
 - (c) For which the person is not allowed a deduction under another provision.
9. The deduction must be allocated to the income year in which the person decides not to lodge the application, withdraws the application, or is refused the grant.
10. The difference is that the change will allow a deduction for an *intended application* that is abandoned, as opposed to an actual application.

Expenses in application for plant variety rights

11. Effective from the 2014-15 income year onwards, s. 48 of the Employee Allowances Tax Amendment Act 2014 has inserted a new s. DB 40BA headed “Expenses in application for plant variety rights”. A person who incurs expenditure for the purpose of applying for the grant of plant variety rights and does not obtain the grant because the application is not lodged or is withdrawn, or because the grant is refused, is allowed a deduction for the expenditure:
 - (a) That the person incurs in relation to the application or intended application; and
 - (b) That would have been part of the cost of fixed life intangible property, or otherwise a deduction, if the application or intended application had been granted; and
 - (c) For which the person is not allowed a deduction under another provision.
12. The deduction must be allocated to the income year in which the person decides not to lodge the application, withdraws the application, or is refused the grant of plant variety rights.

Clawback for subsequent applications or disposal of application property

13. Effective from the 2014-15 income year, s. 19 of the Employee Allowances Tax Amendment Act 2014 has inserted a new s. CG 7B, which will serve to claw back deductions taken under replaced s. DB 19, replaced s. DB 37 and new s. DB 40BA if:
- (a) A person has a deduction for expenditure under s. DB 19, DB 37 or DB; and
 - (b) Property, referred to as “**application property**”, is acquired as a result of the expenditure; and
 - (c) The application property is disposed of for a consideration, or is used in:
 - (i) Obtaining the grant of a resource consent; or
 - (ii) The lodging of a patent application with a complete specification; or
 - (iii) Obtaining the grant of plant variety rights.
14. In the case where the application property is disposed of for a consideration, the amount that will be clawed back, as income in the year of disposal, is the lesser of:
- (a) The amount of the consideration that is not income under any other provision in the *Income Tax Act 2007*; or
 - (b) The total deductions claimed under s. DB 19, s. DB 37 or s. DB 40BA.
15. In the case where the application property is subsequently used in obtaining the grant of a resource consent, or in the lodging of a patent application with a complete specification or in obtaining the grant of plant variety rights, the amount that will be clawed back, as income in the income year of the lodgment or grant, is all of the deductions claimed under s. DB 19, s. DB 37 or s. DB 40BA as appropriate, for expenditure incurred in acquiring the application property.
16. Officials agreed with the submission that deductions for expenditure on an aborted or failed application should only be clawed back to the extent that property obtained as a result of that expenditure is subsequently used in the lodging of a patent application or in obtaining the grant of a resource consent or plant variety rights. This limitation to expenditure in acquiring application property is clearly specified when the property is subsequently used. However, the application of this limitation when property is disposed of for a consideration is not specified.
17. Officials also agreed that a timing-of-income provision should be added to provide clarity about which income year the income is allocated to.
18. Effective from the 2014-15 income year, s. 67 of the Employee Allowances Tax Amendment Act 2014 has inserted a new s. EE 57(3)(cb), which will result in the expenditure that is clawed back as income under s. CG 7B being included in the base value of the resource consent, patent application or patent, or plant variety rights for tax depreciation purposes.
19. Effective from the 2014-15 income year, s. 66 of the Employee Allowances Tax Amendment Act 2014 has replaced s. EE 25(3)(a), with the result that expenditure clawed back as income under s. CG 7B will be included in the cost of a subsequent plant variety rights application for the purpose of calculating the pro-rated deduction for the cost of a plant variety rights application that a taxpayer is allowed when they are granted plant variety rights.

20. Officials also agreed to provide additional clarity around how new s. CG 7B links with sections EE 25 and EE 57, by including a “signpost” within new s. CG 7B. Therefore, a sub-heading in s. CG 7B links the income to the cost in s. EE 25 and the base value referred to in s. EE 57.

New fixed life resource consents included in Schedule 14

21. Resource consents granted under sections 15A or 15B of the RMA have a fixed life of between 5 and 35 years. Effective from the 2014-15 income year, s. 147 of the Employee Allowances Tax Amendment Act 2014 has replaced item 10 of Schedule 14 so that expenditure incurred on resource consents granted under the RMA to do something that would otherwise contravene s. 15A (Restrictions on dumping waste in a marine area) or s. 15B (harmful discharged from ships or offshore installations) can be depreciated over the life of the resource consent.

Further “black hole” expenditure issues

22. Officials stated that their approach is to consider black hole expenditure issues on a case-by-case basis. A comprehensive solution to black hole expenditure, such as a catch-all provision, is not currently under consideration. Officials view is that different black hole expenditure issues will require individual policy solutions to ensure that their tax treatment remains neutral, consistent and fair.



Arun David, Director

DavidCo Limited