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[¶17-501] Practitioner’s viewpoint: Side effects and solutions for Compulsory Zero-Rating of land transactions for GST, 30 November 2017

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The compulsory zero-rating (“CZR”) rules for land in the Goods and Services Tax Act 1985 came into effect on 1 April 2011. Despite the intended simplicity of their application and after more than six years the rules continue to cause problems for both vendors and purchasers. Inland Revenue has taken steps to publicise the intended operation of the regime and highlight its potential pitfalls but taxpayers continue to be caught out. This paper by Paul Smith, GST Partner at EY and Mark Keating, Senior Lecturer in Tax at the University of Auckland Business School considers a range of issues that continue to arise with respect to the CZR rules.

Unique nature of the CZR rules

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Prior to 2011 the GST Act treated the supply of land much the same as any other supply of goods.[1.] A registered person selling land generally paid output tax[2] and a registered person purchasing land claimed an input tax credit.[3] While there was nothing unusual in that GST treatment the quantum paid for land transactions created a fiscal risk to the Revenue. Inland Revenue was obliged to refund input tax to the purchaser of land regardless of whether the vendor accounted for output tax on that supply — even when those parties were associated, in what became known as "Phoenix schemes".[4] This was described as "a structural imperfection under the GST regime." [5]

The Commissioner addressed the problem in the discussion document, *GST: Accounting for land and other high-value assets*, released in November 2009. That document considered a range of possible fixes to prevent the revenue leakage but eventually it was resolved to treat all sales of land[6] between registered persons as zero-rated for GST purposes. Interestingly, while the focus was on preventing Phoenix schemes, the solution applied more widely to all land transactions or any transaction that includes the sale of land between registered persons regardless of the parties' financial risk or compliance history.[7] The definition of "land" was itself expanded to ensure the CZR applied widely.[8] New rules were introduced to catch "commercial leases" to ensure that, while periodic payments of rent are still standard rated, assignments and surrenders of leases fall under the CZR rules.[9]

Section 11(1)(mb) requires zero-rating of all such transactions where two criteria are met:

- The transaction is between two GST-registered taxpayers, and
- The purchaser confirms it will use the land for the purposes of its taxable activity and not as a dwelling for itself or any associated person.

As a result, sales of land as second-hand goods and sales to consumers continue to enjoy the previous GST treatment.

Interpretation statement IS 17/08 states: "The CZR rules effectively streamline the GST cash flow for transactions involving land and, in so doing, are intended to protect the tax base from phoenix schemes."[10]

The streamlining of GST cash flow for transactions involving land through the CZR rules is very apparent as it is no longer necessary to request GST offsets for land transactions between GST registered taxpayers. Previously, it had been common for the parties to separately agree that a purchaser's input tax was to be offset by Inland Revenue against a vendor's output tax liability.[11] The CZR rules make such off-set agreements unnecessary, although they are still occasionally used for significant transactions that do not have a land component, such as a sale of business assets.

Unfortunately, the CZR approach has yet to be extended to other transactions whereby the streamlining of GST is overdue. For example, the need for the streamlining of the administration of GST on imports of goods by GST registered persons has only recently been acknowledged through a review of the Customs & Excise Act 1996[12] . The extension of CZR for imports of goods made by GST-registered persons would be an effective way of achieving this streamlining.[13]

Documentation

To prevent disputes between parties over the GST treatment of transactions (as had been experienced by Inland Revenue when parties to the zero-rated sale of a "going concern" treated that transaction inconsistently[14]) the CZR rules for land took a unique approach:

- First, the zero-rating of land transaction is compulsory, and therefore the lack of any written agreement as to that treatment by the parties themselves does not affect the GST treatment (otherwise most compliant taxpayers would adopt the zero-rating treatment while Phoenix scheme participants would simply decline to do so, which would defeat the primary purpose of the new rules), and
- Second, the vendor is entitled to rely upon the written confirmation of the purchaser regarding its GST registration status and intended use of the property, even if that statement is accidentally or

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intentionally incorrect.[15] This treatment is contrary to the "going concern" rules whereby the Act takes a substance approach and even mutual agreement between the parties will not displace the correct GST treatment if that transaction is not, in fact, the supply of a going concern.[16]

• Finally, provided the vendor obtains the purchaser's written confirmation, the liability for any error in the GST treatment passes to the purchaser.[17] Unlike all other types of zero-rated supplies, whereby the vendor remains responsible for ensuring the requirements for zero-rating are satisfied, and bears the risk if they are not, the GST liability for incorrectly zero-rated land transactions passes to the purchaser. In effect, the GST liability "follows the land" presumably on the assumption that the Commissioner will still have access to that asset to recover the outstanding GST.[18]

In that regard the CZR rules are unique in both applying a zero-rated treatment even when the substance of the transaction does not satisfy the statutory requirements and in passing the resulting GST liability to the purchaser. In a practical sense this means that the GST treatment may be determined by the confirmation provided by the purchaser rather than the reality of the transaction itself.

ADLS standard agreement for sale of land

Given the importance of the documentation, it made practical sense to incorporate that into the standard Sale and Purchase agreement itself. The standard Auckland District Law Society agreement ("ASP")[19] was therefore amended in 2012 to encompass the statutory requirements.[20] The effect of those changes was to incorporate the CZR rules and terminology from the GST Act into the parties' bargain.[21]

First, on the cover page the vendor is required to stipulate if it is (or is deemed to be)[22] GST-registered with respect to the land being sold.

Second, Schedule 2 requires the purchaser to stipulate (with respect to itself or any subsequent nominee) both:

• whether it is (or will be at the time of settlement) GST-registered and, if so
• whether the land being purchased will be used for the purpose of its taxable activity or as a domestic dwelling for the purchaser or an associated person.

Receipt of that written statement allows the vendor to be satisfied the land can be zero-rated, even if the vendor is aware that the statement is accidentally or deliberately incorrect.[23]

Third, cl 15 was inserted into the ASP to record the GST consequences for the parties upon settlement. This clause also provides for changes to either party's GST status prior to settlement and for nomination or assignment of the purchaser's rights under that agreement.

In particular, cl 15 requires the purchaser to notify the vendor of any nomination or change in particulars in Schedule 2 at least two working days before settlement. If that change alters the GST position, the agreement provides for an amended settlement statement, and a credit or debit note may be issued by vendor. Accordingly, the ASP provides for the possibility of changes to the GST treatment between contracting and settlement.

The obvious intention of those changes was to provide for all eventualities. As recognised by the High Court in *YL NZ Investment*:[24]

> "the intention of the [ADLS] agreement is clear. Those who prepared the agreement, knowing it was going to be used widely throughout New Zealand for any number of real estate transactions for a wide variety of properties, could not have made themselves clearer …."

However, while the ASP proves adequate for most land transactions, the operation of those clauses sometimes causes problems. As explained by one commentator in 2012:[25]

> "GST is a transaction-based, value added tax. The GST impost should be clear for every transaction from the outset. The lack of clarity at this crucial junction can cause considerable cost.… It may be

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> that simplicity in this complex area is just too much to ask. However, the level of complexity and the number of fish hooks currently inherent in the legislation and the application of the ADLS clauses are excessive."

That commentator proposed a number of reforms both to the GST Act itself and the ASP to simplify and clarify the application of the CZR rules. None of those recommendations have been taken up and, as set out below, a number of significant problems remain.

Pricing

The ASP provides two alternative and mutually exclusive formulations of the contract price:

- "plus GST" (if any), or
- "inclusive of GST" (if any).

The "plus GST" price generally protects vendors; any GST imposed on the transaction may be added to the sale price thereby increasing the proceeds from which they can account for GST output tax.

The "inclusive of GST" price can benefit a purchaser because they cannot be asked to pay an additional amount towards the vendor's potential GST liability. This pricing will be especially beneficial if that purchaser is subsequently able to make a GST input tax claim based on that agreed price.

However, it must be noted that the reference to GST in the price does not determine that GST does (or does not) apply.[26] The parties cannot by contract agree to a GST treatment that is incorrect. For example, an agreement that a particular sale price is "GST inclusive" does not determine that GST is actually payable on that price. In the alternative, an agreement that the price is "zero-rated" will not mandate that treatment applies if the transaction should actually be standard-rated — and the vendor is generally not entitled to increase the sale price to recover that GST from the purchaser.[27] So the GST Act provides little relief to the parties when the agreed pricing is inconsistent with the actual GST treatment of the transaction.[28]

Unresolved issues

From the time the CZR rules came into effect, commentators feared they would cause new and unexpected issues. Explaining those rules in 2011 one commentator concluded:[29]

> Their significance can be gauged by the fact that all parties to land transactions that are within the GST net are affected by them and by their consequences for mortgagees and agents. Regarding the uncertainties, it is hoped that Inland Revenue guidelines will for the most part resolve them.

Unfortunately, the predicted uncertainties have become apparent and little guidance has been provided by Inland Revenue. Those unresolved issues, and some suggested solutions, are set out below.

Problem 1 — Change in GST treatment by purchaser

As the ASP provides for changes in GST status prior to settlement, it is possible that a GST registered purchaser who has completed Schedule 2 may advise that it has changed its mind and now plans to either not use the property for its taxable activity or plans to use it as a domestic dwelling. In effect, the purchaser has unilaterally changed the GST treatment of the transaction.

For example, a GST-registered vendor sells land to a GST-registered purchaser. The transaction must be zero-rated and therefore the $500,000 sale price will be the GST-exclusive amount, with the vendor not liable to return output tax and the purchaser unable to claim input tax. However, prior to settlement the GST-registered purchaser changes its intended use so that the CZR rules can no longer apply. Depending on whether the price has been plus GST or GST-inclusive, the vendor may have to return unexpected output tax out of its sale proceeds — and the purchaser may eventually claim an equivalent input tax credit under s 21G if in future it again changes its mind to apply that property to its taxable activity.

Solution 1 — This problem can be overcome if the correct pricing is chosen by the parties under the ASP. If the parties contract on a "plus GST (if any)" basis, then any change in the purchaser's GST status will result in an increase in the GST price to ensure the vendor is not out of pocket.

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Solution 2 — Unfortunately the use of "inclusive of GST (if any)" in the pricing of what are prima facie CZR transactions is common.[30] Given the obvious potential for purchasers to seek to gain an effective 15% reduction in the purchase price, the authors are aware of instances where unscrupulous purchasers have taken advantage of unwitting vendors to "change their mind" prior to settlement only to immediately "change it back again" after settlement in order to claim an input tax credit on what would otherwise have been a zero-rated sale. While Inland Revenue has commonly refused to become involved in such disputes and simply expected the parties to comply with the pricing stipulated in their agreements, presumably this practice should cause the Commissioner concern as it would return that transaction to the standard GST treatment that applied prior to the introduction of the CZR rules.

Problem 2 — "C" is for compulsory

A related problem has arisen when the parties (sometimes associated persons or related parties) simply have not adequately completed the necessary documentation required under the CZR regime. In those instances there appeared to be initial confusion within Inland Revenue as to the correct treatment. For instance, if the purchaser has provided none of the necessary written statements regarding its GST status or intent regarding the property in Schedule 2 of the ASP (but in fact is GST-registered and intends the property for a taxable use), is the transaction zero-rated? Or should the vendor be subject to output tax?

The authors are aware of Inland Revenue investigators taking the position that the absence of the correct documentation altered the GST treatment and therefore the standard pre-2011 GST treatment applies. Inland Revenue proposed to not apply the CZR rules but instead impose output tax on the vendor — which presumably would have given rise to an entitlement to input tax by the purchaser.

That approach cannot be correct. The very "compulsory" nature of the CZR rules was intended to prevent land transactions (particularly between associated persons) from giving rise to output liability and input claims, to prevent Phoenix schemes. The opening words of s 11(1) provide that a supply coming with the situations described in that subsection "*must* be charged at the rate of zero per cent". The wording is in a mandatory form.

If the CZR regime could be circumvented by the simple expediency of a purchaser (possibly falsely) asserting that its purpose for that property was not a taxable use, then the door would be ajar for parties to knowingly ensure their documentation failed to satisfy the CZR requirements and thereby return to the standard pre-2011 GST treatment, with all its fiscal risk for the Commissioner.

Solution — The solution to this problem lies solely with the Commissioner. Unfortunately, the policy issued at the time the CZR rules came into effect advised vendors in doubt to standard-rate transactions:[31]

> If the purchaser either refuses or for any other reason has not provided a written statement regarding their GST registration status and intentions in respect of land, the supplier should standard-rate the transaction ….

The Commissioner's interpretation statement on the operation of the CZR rules,[32] referred to above, does little to resolve the confusion. While that policy sets out in detail how errors in the correct GST treatment should be resolved, it repeatedly advises vendors to standard rate a land transaction in the absence of the necessary purchaser declarations. For instance:[33]

> "A vendor should consider standard-rating a supply involving land if the purchaser fails to notify them about their GST-registration status and their intentions for the land, unless the vendor is confident at settlement the CZR rules will apply to the supply. … Of course, in so doing, there is a risk a vendor may wrongly decide to standard-rate the supply and corrections will be needed."

Later it concludes more firmly:[34]

> "If the purchaser refuses to or does not provide the required information about their GST-registration status and their intention for the goods acquired (including land), it is recommended the vendor standard-rates the transaction."

Based on the experience of the authors, this is clearly the approach most likely to be adopted by investigators of Inland Revenue. Strangely, many investigators seem reluctant to actively enforce the purchaser's GST obligations for GST on the purchase of land that was wrongly zero-rated. .[35] However, as the information disclosure requirements in s 78F apply to both GST-registered taxpayers and taxpayers who are not registered for GST, this is unlikely to be an easy task for Inland Revenue. It should also be noted that deliberate non-compliance or making false statements under s 78F may potentially expose purchasers to both shortfall penalties[36] and criminal penalties[37] .

Despite the above, the interpretation statement confirms that the application of the CZR rules "is an objective test"[38] and therefore not simply dependent upon the written statements made by the purchaser (or absence thereof).[39] Rather, the written statement merely provides comfort for the vendor (by passing any potential GST liability on to the purchaser)[40] but is not a prerequisite for the CZR rules to apply; and a supply that factually meets the statutory criteria should not become standard-rated simply by the parties innocently or deliberately failing to complete the necessary documentation. On that basis the Commissioner's recommendation that vendors standard-rate the transaction appears questionable.

That conclusion is supported by the Court of Appeal in *Y& P NZ Ltd v Wang*. In that instance the purchaser had declared in Schedule 2 that it was not GST-registered and therefore the parties treated the transaction as standard-rated. Immediately prior to settlement the purchaser's solicitors revealed that their client had changed its GST status and therefore required the transaction to be zero-rated. The vendor refused to accept that change (due to a lack of adequate notice) and insisted upon continuing to treat the transaction as standard-rated.

In the subsequent dispute the Court of Appeal noted:[41]

> "The Attorney-General, who was joined to this appeal as intervener, supports the appellant's submission that the requirement for notice of the s 78(2) matters cannot be waived. He submits s 78F exists primarily for the benefit of the tax base and to enable the efficient functioning of the GST system. As such, its requirements cannot be waived by a vendor. He also submits that s 11(1)(mb) has mandatory effect. Regardless of what the vendor knows at settlement, GST is zero-rated if the criteria in s 11(1)(mb) are met. Where the wrong rate of GST is applied at settlement, there are provisions to correct the position. … we consider there is force in the Attorney-General's submission that the provision is for the benefit of the tax base and not for the sole benefit of the vendor."

This reasoning confirms that it is the GST status of the parties that determines the correct GST treatment and not the documentation (or lack thereof) or formal notice requirements for any change of that status stipulated in their agreement. This raises the possibility that if a purchaser has actually changed its status then the GST treatment must change accordingly — even if inadequate notice of that change is given to the vendor or it is entirely unaware of that change.

Problem 3 — Nominee transactions

Another common difficulty faced by vendors is the ability of purchasers to nominate an alternative buyer under the agreement. Again, such a nomination causes difficulties when the original purchaser and the nominee have a different GST status or different intended use for the property.

As with the example above for Problem 1, if the GST-registered parties agree the price is to be "GST-inclusive (if any)" but the purchaser then nominates an unregistered person to take over the contract, the CZR rules can no longer apply. The vendor must then return unexpected output tax from its sale proceeds — and presumably the purchaser may eventually claim an equivalent input tax credit under s 21G if in future it again changes its mind to apply that property to its taxable activity. Crucially, IS 17/08 confirms that:[42]

> "A vendor cannot rely on a purchaser's statement where a nomination occurred, unless the purchaser's statement is about the nominee's position. Ultimately, it is the GST-registration status and intentions of the recipient of the supply that must be communicated in writing to the vendor before or at settlement."

Again, the risk of nomination creates the opportunity for unscrupulous purchasers to take advantage of unwitting vendors by nominating an unregistered purchaser, only for that entity to immediately commence its taxable activity after settlement in order to claim an input tax credit on what would otherwise have been a zero-rated sale. The Documents and Precedents Committee of the ADLS has warned practitioners a number of times to watch out for instances where purchasers have either changed their status prior to settlement from being registered to unregistered for GST purposes or have nominated an unregistered entity.[43]

Solution 1 — The vendor should always ensure the nomination satisfies the requirements under the agreement. The ASP recognises and permits the purchaser to nominate another buyer — and that the nominated person's GST status need not be the same as the original purchaser, and therefore may alter that zero-rated GST treatment, as provided in Clause 15.5.

However, cl 15.5 also stipulates the time-period within which the purchaser must advise the vendor of any such nomination that *"altered particulars and of any other relevant particulars in Schedule 2"*. That clause provides that the purchaser *"shall notify"* any such alteration of the GST treatment provided in Schedule 2 *"as soon as practicable and in any event no later than two working days before settlement."*

That time limit is stipulated so the vendor can know the correct GST treatment at least two days prior to settlement when preparing the required GST invoice and other settlement documents. It sensibly prevents last-minute changes of GST treatment that would require those documents to be redrafted. The time limit in cl 15.5 is presumably included for the benefit of the vendor, not the purchaser.

Accordingly, vendors should ensure the purchaser does, in fact, comply with the requirement for two working days notice as an absolute minimum.[44] Problems arose in *Y&P NZ Ltd v Wang* when the vendor appeared to have waived the notice period. There the vendor's solicitor's issued settlement statements to the purchaser on the basis it was not GST-registered so the transaction was standard-rated, based on the information contained in Schedule 2. However, the day before settlement the purchaser advised the vendor of a change in GST status such that the transaction should now be zero-rated. The vendor's solicitors amended and re-issued the settlement statements accordingly — but then refused to complete settlement on the basis it had not received sufficient notice of that change as required under the ASP.

Both the High Court[45] and Court of Appeal[46] accepted the purchaser's allegation that it was arguable the vendor had waived the two-day notice requirement by issuing the revised settlement statements and therefore could not now refuse to accept notice of the purchaser's changed GST status.

Despite that decision, the authors are aware of at least one instance in which an unwitting vendor was "saved" by the purchaser's nomination being received too late to be effective under that agreement. It is therefore crucial that vendors strictly enforce (and do not waive) the notice requirements under the agreement.

Solution 2 — Again, this problem can be solved by the vendor ensuring the price is recorded as "plus GST (if any)" rather than "inclusive of GST" (discussed above). But we also recommend the ASP be amended to explicitly prevent the purchaser from unilaterally changing its declared GST status (whether because of changes to its particulars in Schedule 2 or resulting from a nomination). The agreement should require that the purchaser or any nominee maintain the original GST treatment of the transaction as recorded in the agreement as it was first signed. In the absence of any amendment to the ASP, we recommend the parties include a special condition to that effect.

Solution 3 — The vendor may need to involve Inland Revenue. In many of these instances the unregistered status of the purchaser is, at best, temporary and may be illusory. The land being sold may be such that any purchaser is bound to be GST-registered because the turnover arising from the land would exceed the mandatory registration threshold.[47] While some properties possibly have a non-taxable use, others are clearly for a taxable purpose. Anything done by the purchaser to commence that taxable activity (presumably including purchase of the land) may therefore be included within that taxable activity.[48] In those circumstances, the purchaser may be liable to be registered for GST (and therefore the CZR rules would apply to that transaction) regardless of any contrary statements by the purchaser at the time of settlement.

Inland Revenue recognize this potential in interpretation statement IS 17/08:[49]

> "… a purchaser's circumstances might change and they fail to notify the vendor of the change before settlement, or a purchaser might enter into an agreement on the basis they will not be GST-registered, but it transpires that, in fact, they will be or should have been GST-registered at or before the settlement date. Sometimes, the Commissioner will back-date a person's GST registration."

While this solution is dependent upon the assistance of Inland Revenue, in the authors' experience any claim for input tax by a purchaser of land normally generates a risk review or an audit and the correct GST status of that transaction is therefore subject to scrutiny.[50] Given the obvious financial risk faced by Inland Revenue from standard-rated transactions, it has an inherent bias in favour of CZR treatment. As a result, it is not uncommon for Inland Revenue to apply the involuntary registration provision[51] to the parties to land transactions to ensure the correct CZR treatment.[52]

Problem 4 — Time of supply

The standard time of supply rules in s 9 continue to apply to the sale of land, including transactions subject to the CZR rules. Accordingly, where that transaction occurs across different GST periods, the GST-registered vendor is required to determine the GST treatment of the transaction as at the time of supply (often upon receipt of the deposit). That vendor must therefore either return output tax on that transaction or not depending upon the information provided by the purchaser in Schedule 2 of the agreement.

Unfortunately, the GST treatment of that transaction under the CZR rules is not determined until the time of settlement.[53] As one commentator notes:[54]

> "It is important to test the GST position at time of supply **and** again at settlement in relation to CZR transactions. This area represents an area of commercial risk and gives rise to a state of CZR flux."
>
> [original emphasis]

The ASP contemplates that GST treatment may change during that period. As one commentator has noted:[55]

> "There is no explanation as to why … s 11(8B) should be subject to the time of supply provisions."

This inconsistency between the standard time of supply rules and the CZR requirements obviously raises the possibility that the GST treatment of that transaction originally returned by the taxpayer on one basis subsequently changes by the time of settlement. That previous return is now incorrect, thereby potentially giving rise to a GST shortfall, with the consequent imposition of use of money interest on any underpayment by the vendor or improper input tax refund issued to the purchaser. Given that uncertainty, the authors are aware of instances when Inland Revenue appears to deliberately withhold the issue of a claimed refund pending correct application of the CZR rules.[56] This practice is implicitly acknowledged by the Commissioner in IS 17/08 which confirms that:[57]

> "Payment of any resulting refund may be withheld pending any review of the transaction by Inland Revenue."

The many problems caused by this timing inconsistency are recognized and explained in IS 17/08[58] — but few practical solutions are offered, other than the necessity for the parties to invoke the credit and debit note provisions to retrospectively remedy any error in previous returns.[59]

From a practical perspective, the problems are exacerbated in situations where the vendor is registered for GST and files returns on a monthly basis.[60] Such a vendor may have sold multiple lots over prior taxable periods, each with a different time of supply or settlement date. The possibility that the GST registration status of each of those purchasers may change at any time prior to settlement causes needless uncertainty.

Given Inland Revenue actively monitors the transfer of land,[61] the authors recognize the practical difficulty that property developers experience in responding to queries by Inland Revenue regarding their GST compliance for the sale of land both at the time of supply and upon settlement.

Solution — the most obvious solution would be to make the time of supply rules for land apply at the time of settlement, bringing them into line with the CZR rules. This change would ensure the necessary documentation (and any subsequent notification of a change in GST treatment) is determined at settlement, as required under both the ASP and the CZR rules. That change would ensure the correct tax treatment of the transaction is included in that single GST period without the need for the parties (and Inland Revenue) to correct that treatment by way of subsequent debit or credit notes.

An alternative solution would be to extend the GST return filing period for all taxpayers who deal in land. Currently, a GST-registered taxpayer may file GST returns on a monthly, two-monthly, quarterly[62] or six-monthly basis depending on the taxpayer's circumstances. A longer GST return period for such taxpayers to reflect the standard delay between agreement and settlement (eg two-monthly or quarterly) may assist in addressing the inconsistency highlighted above.

Problem 5 — Wrongly unregistered vendor

Obviously, the CZR rules are premised on the assumption the vendor is GST-registered; sales of land by unregistered persons are outside the scope of the Act. The front page of the ASP therefore requires the vendor to declare their GST registration status with respect to that land.[63] If the vendor declares it is not GST-registered, then the transaction will be treated as a private sale, and the GST-registered purchaser may claim a second-hand goods input tax credit.[64] But the purchaser's input tax credit is reliant upon the correctness of the vendor's declaration. If that declaration is incorrect (and the vendor either is GST-registered with respect to that land or is not but should have been), then the transaction will be subject to the CZR rules — and the purchaser will not be entitled to its input tax credit.

An example of this problem arose in *YL NZ Investment Ltd v Ling*[65]. There the vendor declared it was not registered for GST and the purchaser therefore claimed an input tax credit for the purchase. Following an investigation Inland Revenue concluded that the vendor should have been GST-registered and backdated her registration to a date before the transaction so that the CZR rules applied. Unfortunately, the consequences were that the unwitting purchaser was denied its input tax credit — and therefore sued the vendor for breach of its warranty.

The High Court ruled in favour of the purchaser and awarded damages reflecting the quantum of the expected GST input tax credit plus the adviser fees for dealings with Inland Revenue to correct the GST treatment. The Court rejected the vendor's argument that its declaration was technically correct regarding its actual GST status when made. The High Court explained:[66]

> "When entering into the agreement, the purchaser needs to know the GST implications of the transaction. It is no good for the purchaser to be told that the vendor is not registered if in fact the transaction turns out to be compulsory zero-rated because the Inland Revenue determines that the vendor was carrying on taxable activities in respect of the property the subject of the supply so as to bring her within the GST Act."

That decision is based partly on the inability of purchasers to accurately determine the GST status of a vendor and the ASP requirement that vendors declare their correct GST status, otherwise "it is hard to see how the purchaser could avoid the risk".[67] Somewhat unhelpfully, Inland Revenue has taken the approach that its secrecy obligations[68] prevent it from disclosing information about the GST registration status of counterparties or details of any investigation that concludes a vendor should have been registered and therefore a purchaser cannot claim input tax on the purchase.

Given the Commissioner's Interpretation statement IS 17/08 is largely devoted to correcting mistakes in the GST treatment of land transactions, it is disappointing that Inland Revenue refuses to cooperate with parties by providing accurate and timely information to ensure the GST treatment of their land transactions is correct in the first instance. Presumably, the general exception within the secrecy rules permitting disclosure of information *"for the purpose of carrying into effect the Revenue Acts"* would permit such disclosure.[69]

Solution — While the result in *YL NZ Investment* is helpful, it still exposes purchasers to expensive litigation and the possible insolvency of the vendor. As a practical solution, the authors recommend that if purchasers

of land suspect that their transaction *might* be subject to GST at the standard rate, they should take steps to protect themselves against the risk the vendor is mistaken regarding its proper GST status. For instance, purchasers may require 15% of the purchase price be retained separately by the vendor's solicitor pending release of their input tax claim by Inland Revenue, and for the return of those funds if that input tax is refused due to an error in the vendor's GST declaration. This requirement will be only a temporary inconvenience for a vendor confident in its GST status — but create an effective self-help remedy for a purchaser against any mistake by a vendor regarding that status.

Problem 6 — Wrongly registered vendor

An alternative problem arises when a vendor mistakenly declares its GST-registered status on the ASP and the transaction is therefore (wrongly) zero-rated. This may occur if the Commissioner exercises her power to retrospectively cancel the vendor's GST registration.[70] In that instance the vendor becomes liable to pay output tax on the value of that land at the (retrospective) date of its de-registration.[71] The land transaction should have been treated as a private sale with the purchaser entitled to claim a second-hand goods input tax credit for the purchase.

That problem arose in *Jackson Surridge Property Group Ltd v Eastern Star Group Ltd*[72] where the parties entered into an agreement to sell land valued at $1m, inclusive of GST. The parties then obtained accounting advice and identified that, as they were both GST-registered, the transaction was subject to the CZR rules. Accordingly, they amended the sale price to $870,000 plus GST.

Before the transaction settled the Commissioner retrospectively de-registered the vendor, with the result that it was obliged to pay GST output tax of $130,000. The vendor could not recover that liability by increasing the purchase price since it was now not GST-registered and the "plus GST (if any)" pricing did not technically apply.

The vendor claimed the price should be altered under the Contractual Mistakes Act 1977 on the grounds either both parties were mutually mistaken over the GST treatment and/or that the vendor was mistaken and the purchaser was aware of that mistake. The High Court rejected that claim and ordered the vendor to complete the sale at the agreed price of $870,000. It concluded the financial loss arose from its own GST dealings with Inland Revenue and not due to any fault or advantage obtained by the purchaser. The Court concluded that, as the vendor had correctly declared its GST status at the time the agreement was entered into, any subsequent change could not be taken into account under the Contractual Mistakes Act.

This decision sits uneasily with the subsequent result in *YL NZ Investment* whereby the parties are expected to declare not only their current registration status but the correct position, and subsequent changes will amount to a breach of warranty under the agreement. Obviously, that argument was not available to the vendor in *Jackson Surridge* as it was in breach of its own warranty and was the architect of its own misfortune. But it is unsatisfactory that the vendor unwittingly suffered a significant loss (and the fortunate purchaser an unwitting benefit) because of difficulties with the CZR rules.

Solution — Again we suggest the ASP be amended to ensure the CZR rules apply only when both parties are properly registered. If the parties are mistaken about that crucial status and therefore the transaction properly has a different GST treatment to that agreed by the parties, then the price should automatically be adjusted to reflect the correct GST treatment.

Problem 7 — Mortgagee sales

The CZR rules cause unique problems when land is sold by a secured creditor using its power of sale.[73] The CZR rules require that the supply of land must be *"a supply made by a registered person"* — but does that refer to the lender (who may not be GST-registered) or the borrower (who is GST-registered)?

It is generally accepted that the CZR rules refer to the GST status of the borrower and not the lender. This is because s 5(2) stipulates that the mortgagee sale is deemed to have been made by the lender in the course of the borrower's GST-registered activity, even though the resulting GST liability falls on the lender.[74] Inland Revenue explains:[75]

> If a supply of land is made by a lender to whom section 5(2) applies, the purchaser must provide the information required by section 78F to the lender rather than the borrower, for example, the mortgagee under a mortgagee sale.

However, even accepting the application of the CZR rules when the borrower is GST registered, the conduct of the mortgagee sale may itself cause difficulty. A sale by the lender to a registered person will be zero-rated while the sale to a consumer will not. However, the majority of mortgagee sales of dwellings are conducted by auction, with the sale price stipulated to be "inclusive of GST (if any)". This means for a property that may have both taxable and non-taxable use, bidders are not competing on an equal footing — and the actual GST treatment of the transaction with the highest bidder will not become known until after the hammer has fallen.

This risk exists to a lesser extent in relation to mortgagee sales of commercial properties with the sale price typically stipulated to be "plus GST (if any)". Also, there is a greater proportion of sales made by a tender process rather than by auction.

Solution — Sadly IS 17/08 gives no guidance at all regarding mortgagee sales. Accordingly, we recommend excluding mortgagee sales of dwellings from the scope of the CZR rules. The fiscal risk of the CZR rules was of vendors not accounting for output tax; but that risk does not exist for mortgagee sales whereby the creditor assumes direct liability for GST output tax on the sale.[76] Absent that fiscal risk, and given the practical difficulties it caused, there is no justification for including mortgagee sales of dwellings within the CZR rules. Given the greater certainty regarding the use of commercial properties (including commercial dwellings) these mortgagee sales should remain within the scope of the CZR rules).

Problem 8 — Unscrupulous vendor and naïve purchaser

Section 78F permits a vendor to rely upon the written declaration of the purchaser regarding its GST status and intended use of the property. The vendor is therefore not responsible for any errors or omissions in that declaration affecting the GST treatment; instead the resulting GST liability passes to the purchaser.[77] Inland Revenue confirms no duty is imposed on the vendor to determine the accuracy of the purchaser's declaration:[78]

> In some circumstances, the vendor may believe that the information provided by the purchaser is not accurate. In these situations, the legislation provides flexibility for the vendor to adopt the GST treatment that they consider to be correct. For example, if, in contrast to the purchaser's claims the vendor is aware that the purchaser will use the property in question as their principal place of residence, they may but are not obliged to choose to standard-rate the supply. [But …] Once a written statement is provided, the supplier is not required to make any further enquiries regarding the purchaser's circumstances.

Prima facie that treatment is reasonable as it provides comfort to vendors and passes the potential GST liability to the errant purchaser. It is normally appropriate that the defaulting party bears the GST risk. Furthermore, that purchaser will have enjoyed the benefit of a reduced price that does not have a GST component added.

However, the authors are aware of instances where unscrupulous vendors exploit this protection to deliberately pass the potential GST liability to unwitting private consumers who do not understand the GST implications of completing Schedule 2. Such purchasers are advised that providing their IRD number is a standard requirement to complete the ASP, particularly since tax information is now required of all purchasers. Many purchasers are also persuaded to acknowledge they plan to establish a "home office" to superficially satisfy the other requirement for CZR to apply. For example, a naive purchaser may be offered a small discount in return for agreeing to complete Schedule 2 — not realising that by doing so they will assume the full GST liability.

Solution — Obviously *caveat emptor* applies and purchasers should seek independent advice. In reality many do not and are thereby caught out by the unique CZR rules for land. To protect taxpayers from unscrupulous vendors we suggest limits on the application of s 78F similar to those imposed on lenders with respect to returning GST on mortgagee sales under s 5(2). That section allows creditors to *"determine,*

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in relation to any reasonable information held" whether the debtor was GST registered with respect to the secured asset. Factors such as the nature of the asset, information known about the debtor and other relevant details must be weighed to ensure the correct GST treatment of mortgagee sales on the best understanding available.[79]

We recommend a similar requirement be imposed on vendors to ensure they may not rely solely upon the deeming effect of s 78F regarding the sale to naïve or unwitting purchasers of what are obviously domestic dwellings. Alternatively, the ASP could be amended to require the contract price be stipulated in both the GST-inclusive and -exclusive formulation, and require that purchasers who complete Schedule 2 are liable only for the GST-exclusive price (with the GST amount clearly stated as being payable to the Inland Revenue if that zero-rating is found to be incorrect).

Problem 9 — Mixed use land

A long-standing problem with the GST treatment of land is its possible mixed use. Even prior to the introduction of the CZR rules the GST treatment of land used partly for business and partly for non-taxable or residential use created difficulties.[80] As a result, various statutory amendments were required to separate the elements of the supply to differentiate the taxable and non-taxable portions.[81] The outcome was that the (generally) non-taxable supply of a domestic residence was deemed to be separate from the remaining taxable supply.

But those existing rules focus upon the nature of what is being supplied by the vendor to determine its output tax liability (ie how much of that supply of land is subject to output tax and how should it be apportioned).

By contrast, the CZR rules focus upon the use to which the purchaser intends to apply the land, and passes the output tax liability to the purchaser for any portion of the land it does not use for making taxable supplies.[82] However, the interface between the vendor's and purchaser's obligations with respect to the sale of mixed use land is complex. Clauses 15.6 and 15.7 of the ASP now provide for the apportionment of the single supply between its different elements. Unfortunately this necessitates a different GST treatment of each element, which can cause difficulties over the pricing agreed between the parties (some parts of the supply may be plus GST while others are inclusive of GST). This results in increased complexity whereby a single transaction may give rise to both CZR and taxable treatment for both the vendor and purchaser. It can also give rise to significant uncertainty as to whether a second-hand goods input tax credit is available for the non-taxable component of a single supply of land that will be used by the purchaser in making taxable supplies.

Solution — given that the different elements of the mixed supply of land may be treated differently, the parties should allocate their agreed purchase price between the respective parts of that supply. In the event of any uncertainty, vendors are only protected if they ensure all elements of the transaction are priced as "plus GST (if any)". While the traditional problems with the GST treatment of mixed-use land remain, unfortunately the enactment of the CZR rules have simply added a new layer of complexity.

Conclusion

While the CZR rules have solved the fiscal risk to Inland Revenue posed by Phoenix schemes, that solution has largely been achieved by passing the risks to the contracting parties. None of the problems identified above existed under the previous standard-rated GST treatment. It is the attempt to treat some land transactions (but not others) as zero-rated that has created a difficult boundary issue for taxpayers to navigate.

Getting the GST treatment wrong can be expensive for GST-registered taxpayers. First, mistakes may expose taxpayers to shortfall penalties. Given the quantum of GST involved in major land transactions, taxpayers should not assume Inland Revenue will restrict itself to the lower categories of penalties (ie tax shortfall penalties for "not taking reasonable care"). Sometimes Inland Revenue may conclude the defaulting party has been guilty of "gross carelessness"[83] or worse.

Perhaps a better overall solution would be to treat all land transactions as zero-rated (thereby also removing the entitlement to input tax for second-hand purchasers and output tax liability for sales to consumers).

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This would again ensure a consistent GST treatment that will apply in all circumstances. Instead, Inland Revenue's response in most instances is simply caveat emptor and recommending the parties obtain independent advice. If that advice is wrong, then it considers taxpayers should seek redress from the adviser. If advice is not taken, then the taxpayer has no one else to blame. But the extension of the CZR rules intended to prevent Phoenix schemes so as to catch all registered taxpayers has drawn honest and unwitting vendors and purchasers into its net, and now individual taxpayers are paying the price.

Footnotes

1. For an explanation to the background and scope of the then-newly enacted CZR regime, see P Speakman, "The Compulsory Zero-rating (CZR) rules", *CCH New Zealand Tax Planning Report*, 24 August 2011.
2. Output tax was payable under s 8(1) unless that sale was treated as part of the sale of a going concern under s 11(1)(m).
3. Either under s 3A(1) if purchased from another registered person or under s 3A(2) if it constituted a purchase of second-hand goods from an unregistered supplier.
4. See TIB, Vol 23, No 1, Feb 2011, at p 30.
5. *YL NZ Investment Ltd v Ling* (2017) 28 NZTC ¶23-026, citing "GST in New Zealand" 2017, Thomson Reuters, at 26.1.
6. If the sale of land includes the supply of services then s 5(24) deems those services to be a supply of goods subject to the CZR rules. See Inland Revenue "Questions we've been asked QB 12/07: Goods and services tax — treatment of transitional services supplied as part of the sale of a business (that includes the supply of land)"; TIB Vol 24, No 6, July 2012 at p 65 that holds "transitional services" supplied as part of that transaction involving land should also fall under the CZR rules.
7. See the Taxation (GST and Remedial Matters) Bill 2010 (182-2), p 2.
8. See the inclusion of "commercial leases", a "licence to occupy" and a share within a "flat-owning or office-owning company" within the definition of "land" in s 2(1). Only a mortgage or the lease of a dwelling are excluded.
9. See s 11(8D).
10. Interpretation statement: IS 17/08, Goods and services tax — compulsory zero-rating of land rules (general application), 15 September 2017 at [10] (see *Tax Information Bulletin* Vol 29 No 10, November 2017 at 17).
11. Such requests for a GST offset were typically made by reference to s 173M of the Tax Administration Act 1994.
12. See Customs & Excise Act 1996 Review, Summary of Submissions, March 2015, p 84.
13. Acknowledging that imports by private consumers would need to be excluded from the scope of a CZR regime for imported goods, just as they are from the current CZR rules for land.
14. Under s 11(1)(m); see examples where the parties adopted inconsistent GST treatment of a transaction, which was eventually resolved from 2000 by the requirement that the parties recorded their agreement to the GST treatment in writing.
15. See s 78F Good & Services Tax Act 1985.
16. See *Fatac Ltd (in liq) v CIR* (2002) 20 NZTC 17,902, [2002] 3 NZLR 648 (CA) and *Starrenberg v Mortre Holdings Ltd* (2004) 21 NZTC 18,696, (2004) NZCPR 193 (CA).
17. See s 5(23) and 51B(4)–(6).
18. See s 78E Goods and Services Tax Act 1985 which provides limited relief to vendors who incorrectly zero-rate a going concern, but only where the relevant contract does not contemplate that consequence.
19. Auckland District Law Society Inc "Agreement for Sale and Purchase of Real Estate" (9th Edition); see also schedule 3 to the Auckland District Law Society Inc "Agreement for Sale and Purchase of a Business" (2008).

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20 For a fuller discussion of those changes see *S van Schalkwyk*, “GST zero-rating of land — a critical evaluation of the law and the ADLS standard agreement GST clauses”, *CCH New Zealand Tax Planning Report* 20 November 2012.

21 See *YL NZ Investment Ltd* v *Ling*, above n 5.

22 See the outcome in *YL NZ Investment Ltd* v *Ling*, above n 5.

23 See s 78F Goods and Services Tax Act 1985.

24 *YL NZ Investment Ltd* v *Ling*, above n 5 at [32].

25 See *S van Schalkwyk*, above n 20.

26 See *Newman* v *CIR* (1994) 16 NZTC 11,229 (HC).

27 See *Chesham Investment Ltd* v *Robertson* (1992) 14 NZTC 9,105 (HC).

28 There is no equivalent, for the mistaken zero-rating of land transactions, to the limited relief provided with respect to mistaken zero-rating of “going concerns” in s 78E Goods & Services Tax Act 1985.

29 For an explanation to the background and scope of the then-newly enacted CZR regime, see P Speakman, *“The Compulsory Zero-rating (CZR) rules”*, *CCH New Zealand Tax Planning Report*, 24 August 2011.

30 For example see *Wyatt* v *Real Estate Agents Authority* (2012) 25 NZTC ¶20-152 (HC) where the vendor of land’s claim against the real estate agent for using the “GST inclusive” pricing formulation failed. The previously unregistered vendor had been indifferent to the pricing clause but could not recover the additional GST when it was subsequently registered for GST by the Commissioner with respect to that sale.

31 See TIB Vol 23, No 1, Feb 2011, at p 30.

32 Interpretation Statement IS 17/08 “Goods and services tax — compulsory zero-rating of land rules (general application)”, above n 10.

33 IS 17/X08, above n 10, at [23].

34 IS 17/08, above n 10, at [59].

35 Under ss 78F and 5(23) Goods & Services Tax Act 1985.

36 For example, the penalty for failing to take reasonable care under s 141A Tax Administration Act 1994.

37 For example, s 143(1)(b) Tax Administration Act 1994.

38 S 17/08, above n 10, at [55].

39 See Inland Revenue “Large Enterprises Update — Number 18”, February 2012.

40 Under s 5(23), pursuant to s 78E.

41 *Y&P NZ Ltd* v *Wang* (2017) 28 NZTC ¶23-021 at [22] and [25].

42 IS 17/08, above n 10, at [24].

43 See ADLS *Law News* Issue 30, 27 June 2014.

44 Note cl 1.3(5) expressly excludes the day of notification from the calculation of the required notice period.

45 *Wang v Y&P NZ Ltd* (2016) 28 NZTC ¶23-004 (HC).

46 *Y&P NZ Ltd v Wang* (2017) 28 NZTC ¶23-021 (CA).

47 Presently $60,000 in any 12-month period, under s 51 Goods & Services Tax Act 1985.

48 Under s 6(2) Goods & Services Tax Act 1985.

49 See IS 17/08, above n 10, at [62].

50 As explained in IS 17/08, at [71] which explains that “What happens if the supply was incorrectly standard-rated”. It also advises [at 77] that “Depending upon the circumstances giving rise to the error the purchaser may be liable for shortfall penalties.”

51 See s 51(4) Goods & Services Tax Act 1985.

52 For example, see *YLNZ Investment Ltd* v *Ling*, above n 5 where Inland Revenue compulsorily registered for GST a taxpayer who purchased and quickly on-sold a large block of development land,

thereby ensuring that at least the on-sale transaction was subject to the CZR rules. See also *Jackson Surridge Property Group Ltd* v *Eastern Star Group Ltd* (2015) 27 NZTC ¶22-019 where the GST registration of the vendor was retrospectively cancelled between the date of the zero-rated transaction and the date of settlement.

53 Under s 11(8B) Goods & Services Tax Act 1985.

54 E Trombitas, "GST and Land Transactions", NZJTLP Vol 23, No 1, March 2007.

55 GST in New Zealand, 2017, Thomson Reuters, at 15.6.5.

56 Inland Revenue has 15 working days within which to release the GST refund, pursuant to s 46(1) Goods & Services Tax Act 1985, unless *"the Commissioner is not satisfied with a return made by a registered person"* in which case it may withhold the refunding pending any request for additional information or investigation.

57 IS 17/08, above n 10, at [71].

58 IS 17/08, above n 10, at [63]–[83].

59 Under s 25 Goods & Services Tax Act 1985.

60 Under s 15(4) Goods & Services Tax Act 1985.

61 See www.linz.govt.nz.

62 Currently limited to non-resident suppliers of remote services.

63 This question was included in 9th edition of the ASP from November 2013.

64 Pursuant to s 3A(2) Goods & Services Tax Act 1985.

65 *YL NZ Investment Ltd* v *Ling*, above n 5.

66 *YL NZ Investment Ltd* , above n 5, at [31]–[32].

67 *YL NZ Investment*, at [33].

68 Under s 81 Tax Administration Act 1994.

69 See M Keating, "Can you keep a secret? The obligation of secrecy and right to disclose taxpayer information", ATR Vol 38, No 3, 2009.

70 Presumably on the grounds they are not properly conducting a taxable activity under s 51 Goods & Services Tax Act 1985.

71 Under s 5(3) Goods & Services Tax Act 1985.

72 *Jackson Surridge Property Group Ltd* v *Eastern Star Group Ltd* (2015) 27 NZTC ¶22-019.

73 Under s 5(2) Goods & Services Tax Act 1985.

74 Who is required to file a special return under s 17 Goods & Services Tax Act 1985.

75 TIB Vol 23, No 1, February 2011 at p 30.

76 See *Edgewater Motel Ltd v CIR* (2004) 21 NZTC 18,664 (PC) and *Simpson and Downes v CIR* (2011) 25 NZTC ¶20-047.

77 Under s 5(23).

78 TIB Vol 23, No 1, February 2011, at p 30.

79 See TIB Vol 1, No 8, February 1990, at p 30.

80 For example, see *CIR v Smith City Group Ltd* (1992) 14 NZTC 9,140 (HC) and *CIR v Coveney* (1995) 17 NZTC 12,193 (CA).

81 See s 5(15)–(19) Goods and Services Tax Act 1985.

82 By virtue of s 5(23) and s 20(3J) Goods and Services Tax Act 1985.

83 Under s 141C Tax Administration Act 1994. Disappointingly, IS 17/08 does not address the potential application of shortfall penalties arising from errors in the application of the CZR rules.

Practitioner’s viewpoint: Trustpower: the black hole problem continues, 10 November 2016

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Trustpower Ltd lost its appeal over whether $17.7m of feasibility costs were deductible revenue expenditure.

The Supreme Court in Trustpower Ltd [1] *ruled that expenditure incurred between 2006 and 2008 to investigate and apply for resource consent for a number of potential power generation projects was non-deductible capital.*[2]

That decision has led to the withdrawal of the Commissioner’s policy regarding the treatment of “feasibility expenditure” in Interpretation Statement 08/02. But more generally, the Supreme Court judgment highlights the unresolved problem of black hole expenditure within the New Zealand tax regime.

Although both the Commissioner and the courts have repeatedly recognised this as a problem, attempts to solve it have been piecemeal and largely unsatisfactory. One knowledgeable commentator explained how taxpayers deal with black hole expenditure in practice:[3]

> *“This has long been a frustration for business. … Teams of tax accountants are employed to minutely scrutinise all such expenditure to see what can be justifiably pushed into the revenue account category and be deducted.”*

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Possibly because of Inland Revenue's awareness of this practice, investigation of black hole expenditure is common. Given the often large amounts involved, and the difficulty of achieving certainty in this difficult area, judgement calls made by taxpayers as to which side the expenditure falls often give rise to disputes. In this article Tori Sullivan, Director Tax Controversy Team, EY Law and Mark Keating, Senior Lecturer in Tax, University of Auckland, discuss the implications of the Supreme Court decision and consider possible solutions.

It is unfortunate that Trustpower is only the latest in a line of cases wrestling with this problem. In the past year, two other cases have also resulted in expenditure being both non-deductible and non-depreciable: ANZCO Foods[4] *and Queenstown Airport Corporation.*[5]

These three decisions clearly demonstrate the disincentives taxpayers face when investing in large scale capital projects. The wider impact on investment in our economy cannot be ignored and comprehensive reform is needed to provide a more commercially realistic treatment for what would otherwise be black hole expenditure.

Trustpower

Trustpower Ltd ("Trustpower") is a generator and retailer of electricity. It generates about half the electricity it sells and purchases the rest on the electricity market. As part of its wider business operations Trustpower continually assesses the feasibility of potential future generation projects along a "development pipeline process". This consisted of some 200 potential projects at any given time, with a handful of such projects being taken to the resource consent stage. The case considered the deductibility of the various professional and administrative costs incurred by Trustpower in obtaining resource consents on four of those projects.

Although the case turned on the traditional capital/revenue distinction, it was complicated by the Commissioner's policy regarding the tax treatment of "feasibility expenditure" in IS 08/02.[6]

That policy was developed by Inland Revenue in response to the High Court judgment in *Milburn*[7] . That case concerned feasibility expenditure on obtaining resource consents and licences for three of 48 different sites that were potentially suitable for development as a quarry. The company capitalised those costs once the necessary consents were obtained but treated the expenditure on revenue account if those applications failed or the project did not proceed (as there was no asset to which those costs could be capitalised and therefore depreciated).

This treatment prevented the costs on the failed applications from becoming black hole expenditure. Unfortunately, the High Court rejected that pragmatic approach, ruling that expenditure on identifiable projects to which a company has committed itself must be capitalised, even if that project is not completed.

Following *Milburn*, Inland Revenue released IS 08/02 which provided that the tax treatment of feasibility expenditure would turn on both the degree to which those costs related to specific identifiable capital projects and whether the taxpayer had decided to proceed with that project. Under IS 08/02, feasibility expenditure was deductible if it was incurred to put the taxpayer in a position to make a decision on whether to proceed with the particular project. Expenditure incurred after that point was capitalised.[8]

In effect, IS 08/02 drew a distinction between "feasibility expenditure" incurred by a taxpayer prior to making a definitive commitment to proceed with a project and expenditure incurred after that decision. This became the so-called "definitively committed" test.

Under the policy, it did not matter whether the project was successfully completed. If that project was subsequently abandoned or failed, the costs incurred after a taxpayer was definitively committed would have no corresponding asset to be capitalised to and therefore treated as black hole expenditure.

On the definitively committed test, the policy explains:[9]

> "Identifying when a decision to proceed has been reached in any particular situation will always be a question of fact and degree, and it is necessary to weigh all the relevant factors to determine whether a commitment has been made to a project."

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Applying IS 08/02, the taxpayer and the Commissioner in *Trustpower* focused on whether and when the taxpayer had made the decision to proceed with the projects. The taxpayer argued that obtaining the resource consents was merely a further step in the consideration process.

The High Court ruled in favour of the taxpayer.[10] It concluded the resource consents were not stand-alone assets in their own right and the taxpayer could not have made the decision to commit to the process until after such consents were obtained. Rather, obtaining resource consents for potential projects was part of Trustpower's regular feasibility process and so was part of its ordinary business operations. All expenditure on those consents was therefore deductible. The Commissioner appealed.

The Court of Appeal overturned the High Court decision.[11] It ruled that the projects were each separate assets with their own value. As the resource consents expanded Trustpower's business structure they were on capital account.

Relying upon a traditional capital/revenue analysis, the Court of Appeal reviewed the prior case law on the treatment of resource consents (which uniformly found them to be capital assets) and then weighed the traditional tests propounded in the leading capital revenue cases, most notably *BP Australia*.[12] It concluded that, either on their own or as a step towards the larger project, the resource consents were capital assets.

In reaching that decision the Court of Appeal called into question the reasoning in IS 08/02. In particular, it considered that under normal capital/revenue criteria the expenditure on such projects should always be on capital account, regardless of whether the taxpayer has definitely committed to that project. Nevertheless, it accepted that IS 08/02 represented "a pragmatic response to the issue".[13] The taxpayer appealed that decision.[14]

The Supreme Court rejected Trustpower's appeal but on narrower grounds.[15] Although it was expected that the Supreme Court would provide some general guidance on the wider question of the capital/revenue boundary, this did not eventuate. The decision does not include that wider statement of the law, but it nevertheless provides insight into the Court's general approach.

The Supreme Court ruled that the expenditure was directed at identifiable capital projects and obtaining the consents was a "tangible step" towards completing those projects.[16] From those findings it easily concluded the expenditure was non-deductible:

> "The expenditure on obtaining resource consents in this case was directly related to specific projects that would be on capital account if they came to fruition. The projects could not proceed without resource consents. Obtaining the consents thus represented tangible progress towards their completion. The expenditure is thus on capital account and not deductible."

To support that conclusion the Court also reasoned that there was a legislative assumption, reflected in previous case law, that expenditure to obtain resource consents was on capital account. Further, the Court found that the accountancy treatment warranting immediate deductibility of those costs was "not material".[17]

Does "feasibility expenditure" exist as separate category?

For many years both taxpayers and the Commissioner have treated feasibility expenditure as a separate category of expenditure — but the Supreme Court's decision rejected that approach.

Instead, the proper test is whether the particular expenditure represented a step towards the creation of a capital asset. All costs that advance the development of a capital project are therefore capital, regardless of whether the taxpayer is committed to completing that project. Only costs that are so preliminary as not to be directed towards a specific project are still deductible.

In practice, this is likely to lead to more feasibility costs becoming "black hole" expenditure. The Supreme Court was aware of this risk:[18]

> "At this point, we should introduce the problem of expenditure on projects which do not proceed. If such expenditure is on capital account, the taxpayer might be thought to be prejudiced. Because the project never eventuates, there is no corresponding asset or permanent advantage accruing and,

> therefore, nothing to depreciate. Further, because the wasted expenditure is on capital account, there is no available deduction. Such expenditure is sometimes said to have disappeared into a 'black hole'."

The court recognised the undesirability of this outcome from a policy perspective and noted the instances where Parliament had taken targeted steps to alleviate this problem; but held it did not displace the clear operation of the capital limitation where none of those concessions applied:[19]

> "The possibility that some, or all, of the expenditure may in the end turn out to be wasted does not displace the operation of the capital limitation."

The future of IS 08/02?

The Supreme Court flatly rejected the approach in IS 08/02 which focuses on a taxpayer's subjective decision over whether it had definitively committed to a project. The Supreme Court explained:[20]

> "The subjectivity which is implicit in the commitment approach would give rise to some practical problems. This is because a decision whether there was commitment would have to be made in a context in which a taxpayer:
>
> > (a) can be expected to defer commitment as long as possible to maximise the extent to which expenditure can be deducted; and
> > (b) has control of the contemporaneous records (board minutes and papers for example) which will form the basis of the later assessment whether there was a commitment."

On 18 August 2016, Inland Revenue released a Case Impact Statement advising:[21]

> "… the Commissioner will be applying the principles in the Supreme Court's decision in relation to any binding ruling applications, and in any future challenges, and so tax positions taken after the date of the judgment should take the decision into account. However, the Commissioner will not be actively reviewing previous years where taxpayers have applied the Interpretation Statement approach."

Given that conclusion, taxpayers should no longer rely upon IS 08/02.

On 28 September 2016, Inland Revenue released the draft of a revised Interpretation Statement on the "Deductibility of Feasibility Expenditure" to replace IS 08/02. The introduction to that draft statement explains:[22]

> "The Supreme Court approach represents the current legal position, and must be applied by the Commissioner and taxpayers from the date of judgment. As such, IS 08/02 should no longer be relied on. The Commissioner will be applying the principles in the Supreme Court's decision in relation to any binding ruling applications, and in any future challenges, and so tax positions taken after the date of the judgment should take the decision into account. However, the Commissioner will not be actively reviewing previous years where taxpayers have applied the approach in IS 08/02 …"

Inland Revenue explains that the draft policy differs from its predecessor in that:

> "references to 'commitment' as a relevant factor have been removed. This has been replaced with consideration of whether there has been material advancement of (or tangible progress on) a specific capital project (or asset or other enduring benefit)."

The draft also includes two additional examples that consider the deductibility of expenditure that "is preliminary and … does not result in any tangible progress of the project or any capital asset or other enduring benefit" within the narrow exception referred to in the Supreme Court judgment.

Implications for taxpayers

The immediate implication of *Trustpower* is uncertain. Future feasibility expenditure is now obviously governed by the reasoning of the Supreme Court (and not IS 08/02) but what happens to past or current feasibility costs? The following treatment would appear to apply:

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- ***Tax positions taken before the judgment, correctly applying IS 08/02:*** Unlike other instances when Inland Revenue has won a case of wider application, it has not requested remedial action for past years (for example, by calling for a voluntary disclosure). Rather, it has confirmed that it will not actively review previous years where taxpayers have correctly applied the approach in IS 08/02. However, how the Commissioner will treat mistakenly claimed feasibility expenditure for those earlier years when it is identified as part of another audit remains unclear. For taxpayers considering acquisitions or divestment, feasibility expenditure previously deducted in accordance with IS 08/02 may represent a "hidden" tax liability that may (or may not) be uncovered during due diligence and covered by a tax indemnity agreement.
- ***Tax position taken between judgment and withdrawal of IS 08/02:*** Although taxpayers should have technically applied the Supreme Court's decision, IS 08/02 represented "the Commissioner's official opinion" until the Case Impact Statement was released on 18 August 2016. Although there is no estoppel against the Commissioner with respect to the core tax, taxpayers who relied upon the policy during that period should nevertheless be protected from the imposition of shortfall penalties and interest.[23]
- ***Tax positions taken after 18 August 2016:*** Taxpayers must now apply the Supreme Court's decision. Following release of the Case Impact Statement, IS 08/02 is no longer the Commissioner's official opinion and does not provide protection against reassessment, penalties or interest.

Trustpower itself publicly hoped Inland Revenue would not attempt to apply the decision retrospectively. It stated:[24]

> "All eyes now turn to Inland Revenue to find out what its next approach will be. While we see this decision as moving the capital-revenue boundary in Inland Revenue's favour, we hope they will continue to respect tax positions taken by taxpayers to date where they have been consistent with Inland Revenue's previous guidance."

Not surprisingly, the implications of *Trustpower* for other taxpayers have been widely criticised. Much of that criticism (considered below) focuses on the economic impact of black hole expenditure on taxpayers across a wide range of industries. As feasibility expenditure encompasses investigating new processes and services, as well as capital projects, the decision potentially impacts on a wide range of expenditure types, including wages for staff time spent on due diligence, executives' time spent on determining strategy or investigating possible expansion and new investments, and much research and development expenditure. All may now also fall into the black hole.

Unfortunately for taxpayers the outcome in *Trustpower* is not isolated. Two other recent cases have demonstrated the unsatisfactory implications of denying both a deduction and depreciation to expenditure incurred by taxpayers in the normal course of business.

ANZCO Foods

In *ANZCO Foods* the taxpayer incurred costs buying-out a restrictive land covenant to allow for more effective use of that land as part of its business.[25] ANZCO had earlier purchased a number of assets from a competitor, including meat processing plants. However, that sale included a number of restrictions on how ANZCO could use those assets. Subsequently, the parties entered into a settlement, removing those restrictions.

ANZCO treated that settlement payment as fixed life intangible property, being "the right to use land"[26] in a manner that was previously prevented to it. The High Court upheld the Commissioner's disallowance of that depreciation. It ruled:

- ANZCO already had "the right to use the land" as its owner, and the settlement payment only lifted contractual restrictions owed to another party on that use.[27]
- Even if the removal of those contractual restrictions amounted to a right to use land, those rights ran with the land indefinitely so were neither "fixed life" nor could they be reasonably expected to decline in value. While the contractual restrictions had a fixed life, their removal was permanent.[28]

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Therefore, that cost constituted black hole expenditure.

Queenstown Airport Corporation

Queenstown Airport Corporation concerned whether Queenstown Airport Corporation ("QAC") could depreciate the cost of constructing its Runway End Safety Area ("**RESA**").[29] A RESA is an area at the end of the runway intended to reduce the risk of damage to an aeroplane undershooting or overrunning the runway. The Civil Aviation Authority mandated from 2006 that all airports must have a RESA. As Queenstown Airport was built next to the Shotover river, QAC had to engineer and construct a large embankment to gain the space to satisfy the RESA requirement.

QAC claimed depreciation for the cost of the RESA on the basis it was a "land improvement"[30] (within the categories of "airport runway" or "hardstanding" or "roads"). In particular, QAC argued the RESA formed part of the "runway system" operated by the airport, which included not only the landing strip itself but also the safety areas used by the planes. Alternatively, QAC argued that the RESA was hardstanding or road.

Inland Revenue countered that the RESA merely constituted a type of non-depreciable land improvement. It also claimed that, even if the engineering and construction work required to create the RESA constituted "land improvements", it did not reasonably decline in value over time.

The High Court ruled against QAC on all points, finding that the RESA did not constitute depreciable property as it was not:

- "Airport runway" as planes did not take off or land on that area other than in emergencies.
- "Hardstanding" because it was not paved and aircraft would sink into its surface.
- "Road" because it was not generally used as a passageway by planes.

The Court rejected the interpretation advanced by QAC that the RESA formed part of the "runway system". Periodically, Parliament adds new categories of depreciable property to the depreciation schedules — and the Court considered whether to extend depreciation to other assets within an airport's runway system should be determined by Parliament. The Court explained:[31]

> "If a land improvement does not actually come within one of those specified depreciable land improvements it is not open to a taxpayer to contend that, by analogy with some listed items, the land improvement falls within the general purview of Schedule 13. To put the point somewhat differently, it is not the function of the Court to recognise additional new items in Schedule 13. The proper mode of extension of the Schedule 13 list is by legislation ... ".

The Court also concluded that, even if the RESA had come within the existing sch 13 categories, it would still not have qualified for depreciation as it might not reasonably be expected to decline in value while used or available for use. The Court found that despite the RESA's extensive engineering and expected 100 year useful life, provided it received standard maintenance, it would remain indefinitely except in the "rare event of an aircraft undershooting or overrunning the runway"[32] — the very contingency for which it was created. The cost therefore constituted black hole expenditure.

The problem of black hole expenditure

There is no precise definition of black hole expenditure but the concept is both well understood and widely discussed. A practical explanation of the problem from one commentator was:[33]

> "While depreciation is worse than a full deduction in the year the expenditure is incurred it is better than nothing. 'Black hole' expenditure is the name given to expenditure that cannot be deducted in the year it is incurred because of the operation of s DA 2(1) but which does not give rise to a capital asset and hence cannot be depreciated over time. Because the expenditure does not give rise to a capital asset the outgoing is not captured in anything that can be depreciated for tax purposes. The expenditure therefore sits in no-man's land and cannot be deducted. It falls into a 'black hole' so to speak."

The concept of black hole expenditure offends the underlying policy of the Inland Revenue Acts that income tax shall be imposed on the net profit or gain of the taxpayer for the year.[34] That "net income" is calculated by including all income receipts of a business and then allowing a deduction for revenue expenses or depreciation for capital allowances. Black hole expenditure upsets that balance by refusing to recognise a portion of the genuine business costs incurred by taxpayers when calculating their annual net income. Accordingly, the taxpayer pays tax on a "net income" that is not actually enjoyed:[35]

> "As a general proposition there is tax symmetry. A revenue account receipt is taxable and revenue account costs are assessable. Conversely, capital gains are not taxable but capital losses are not deductible either. Depreciation recognised the diminution in value of capital assets over their useful working life. It also recognises that the asset will have to be replaced eventually. Black hole expenditure was and is a breach of the symmetry because it falls into a hybrid category being neither truly revenue in nature nor truly capital in nature because no asset has been generated."

Black hole expenditure imposes an unwarranted tax burden on the taxpayer. It results in a lower after-tax profit for the business and a lower return on investment for stake-holders. It causes an undesirable dead-weight cost, which is either passed on to the end customers or absorbed by the taxpayer.

This outcome is undesirable from the viewpoint of economic efficiency. New Zealand prides itself in a tax policy that adheres (as far as possible) to best practice. Earlier this year, Inland Revenue boasted how its policy design was guided by these objectives,[36] but black hole expenditure clearly breaches those objectives and is out of step with other parts of New Zealand's taxing regime.

That discussion took place with regard to the proposed relaxation of the zero-rating rules for financial services regarding capital raising costs. The proposal [37] stipulates that its aim was to further reduce undesirable outcomes arising from the denial of GST input tax credits to taxpayers providing exempt financial services to GST-registered customers. The Government recognised that refusing deduction for legitimate business costs generally results in those costs cascading through the supply chain and Inland Revenue explained its aim was "to reduce the potential for tax cascades caused by the exempt treatment of financial services, where tax must either be absorbed or passed on by the business receiving the supplies".[38] The problem of tax cascades was explained:[39]

> "Denying deductions for these costs is said to lead to tax cascades, as a taxable business must either absorb the GST cost or pass the cost onto its customers, with GST being charged on this amount again in later stages of the supply chain. … Passing on the cost of this GST may result in a tax cascade, where the unrecoverable GST is embedded in the price paid for the supply, and the supply itself is taxed."

So the undesirability of non-deductible expenditure by business is recognised — and Inland Revenue officials are taking steps to further reduce those problems within the GST regime. Sadly, there are currently inadequate steps to address the equivalent problem of black hole expenditure for income tax.

Piecemeal response to black hole expenditure

The undesirable policy outcome resulting from black hole expenditure has repeatedly been raised as a concern by the tax community over many years.[40]

The problem was examined by commentators in 2011 considering the potential implications for taxpayers incurring feasibility expenditure, using the *Trustpower* dispute (then before the High Court) as an example:[41]

> "The non-deductibility of feasibility expenditure can result in the reluctance of taxpayers to assess the viability of certain capital projects or new product development. Business expenditure on research and development in New Zealand is substantially below the level of the average of the other members of the OECD. One of the reasons for this lamentably low level of expenditure could be this tax problem."

This conclusion implied the problem of black hole expenditure falls not only upon the taxpayer and its customers but also upon the wider economy. It is reasonable to assume that black hole treatment acts

as a disincentive to investment in the areas affected. Certainly, that was the view expressed by media commentators following each stage of the *Trustpower* decision. For instance, it was reported that:[42]

> "Consequently, the Chief Financial Officer of TrustPower is reported as saying that if the dispute is lost, then TrustPower's projects will be curtailed as 'it's a pretty clear signal not to take too many chances around generation development'."

More recently, NZICA (as it was then) made submissions to Inland Revenue pointing out the "perverse incentives for marginal projects" created by the problem of black hole expenditure.[43]

Although the problem has been on the Tax Policy Work Programme for more than a decade,[44] Inland Revenue has engaged in piecemeal reform as specific problems were identified and considered to warrant remediating.[45]

An example of this fire-fighting is found following the High Court decision in *Milburn*.[46] In that case, the taxpayer incurred expenditure on seeking resource consents for possible quarries. The costs of such consents were non-deductible capital but, when the quarry did not proceed, were also not depreciable. To address that obviously unsatisfactory outcome, the capital costs of obtaining certain types of consents granted under the Resource Management Act 1991 were added to the list of "depreciable intangible property" in Schedule 14, with effect from the 1997 income year.[47]

Subsequent other amendments have addressed a range of other instances of black hole expenditure on an ad hoc basis. In 2013 Inland Revenue released a Discussion Document explaining it:[48]

> "… continues this focus on supporting business growth and innovation by suggesting changes to deal with the "black hole" tax treatment … Providing tax deductibility, in appropriate circumstances, for capitalised development expenditure that is currently black hole expenditure has the potential to remove or mitigate economic distortions which may act as a disincentive to businesses undertaking R&D."

Accordingly, in 2013 deductions were permitted for certain costs of obtaining plant variety rights, company administration and failed resource consents.[49] In 2014 deductions were permitted for R&D expenditure.[50]

When introducing those changes, the Minister of Revenue acknowledged that "these amendments will remove certain distortions against investment arising from current tax settings, while reducing compliance costs and providing greater certainty for taxpayers."[51]

Taxpayer response to these measures has been lukewarm. One commentator complained:[52]

> "These two changes deal explicitly with [narrow categories of] black hole expenditure … It will be immediately apparent that although the headlines made it look as if the whole conceptual problem with black hole expenditure was benevolently dealt with by the law changes announced on budget night, that is not in fact the case. The changes address only a very small subset of what is comprised within the concept of black hole expenditure."

More worryingly, that commentator suggested the changes were entirely self-serving and involved the Government attempting to "pick winners" by only allowing deductions for certain favoured expenses:[53]

> "The motivation from a governmental perspective for these changes is unlikely to have been a desire to improve tax symmetry. It is more likely to have been a desire to remove impediments to obtaining of patents, plant variety rights and resource consents. Those assets are ordinarily associated with positive investment activity, which is something that the government wants to encourage."

Despite recognition of the problem, and the fanfare given to incremental steps to resolve limit examples, no wider response has been proposed. Sadly, this lack of progress compares unfavourably with the solution provided in Australia a decade ago.

Australian response to black hole expenditure

The problem of black hole expenditure is not unique to New Zealand. However, the problem is more acute here due to the lack of a capital gains tax regime that would otherwise incorporate those expenses within the cost base of the underlying asset when calculating any capital gain or loss upon eventual disposal (or abandonment) of that asset. While the benefit under such regimes may be long-deferred, it is seldom entirely lost. By contrast, the absence of an equivalent capital gains tax in New Zealand means those costs are truly wasted.

The unsatisfactory nature of black hole expenditure was addressed in Australia in 2006.[54] Section 40–880 of the Income Tax Assessment Act 1997 now provides a deduction for all kinds of black hole expenditure incurred by a business that is not otherwise deductible or depreciable under any other provision and is not included in the cost base of an asset for capital gains tax purposes. Such deduction is taken on a straight line basis for five years from the year in which the expenditure is incurred.

This provision allows for the deduction of capital expenditure types that are presently prohibited in New Zealand, including costs on establishing or reforming the business structure, capital raising costs, expenditure to make or defend against a takeover, and costs associated with the termination of business operations. It would also cover feasibility expenditure incurred on failed capital projects.

The Australian legislation provides that this black hole provision is a last resort and may be utilised only if deduction under another provision is unavailable. But it ensures those costs are spread over a five year period rather than being entirely wasted.

In 2006, Inland Revenue considered introducing a similar comprehensive regime in its Business Tax Review — but was obviously put off by the potential loss of revenue. Inland Revenue estimated that a broader reform to eliminate black hole expenditure would cost the Government between $150m to $300m annually. For instance, the Discussion Document explains:[55]

> "Another example of black hole expenditure is the cost of certain feasibility studies. Allowing such expenditure to be deducted or amortised would clearly have a fiscal cost, though it is not possible to estimate with any accuracy."

In 2013, one commentator simply concluded:[56]

> "Businesses have long called for this concern to be addressed. … It is understood that fiscal constraints prevent New Zealand from following Australia's general solution to the problem."

Until effective reform is introduced the precise costs will remain unknown – but will continue to be carried by taxpayers and their customers.

A case for legislative change

The decisions in *Trustpower*, *ANZCO Foods* and *Queenstown Airport Corporation* are detrimental for businesses seeking to invest or expand. They affect the power generation, agricultural processing and aviation / tourism industries — presumably all sectors of the economy the Government wants to encourage to expand. The results in these cases will undoubtedly lead to more undesirable black hole expenditure in each of those sectors and possibly beyond. It also calls into question wider Government policy to encourage "innovation", as promoted in Budget 2016 and the Business Growth Agenda.[57]

In the view of many commentators there are strong grounds for seeking a comprehensive legislative solution similar to that provided in Australia. For example:[58]

> "Black hole" expenditure … has been a running sore for businesses for years. Steps to remedy existing anomalies are welcome."

Another commentator explained:[59]

> "The deductibility of feasibility expenditure is an important issue for any business that incurs costs in investigating or exploring whether the acquisition or development of new assets is practical or possible. Most businesses look to grow. Growth will usually require increased production (or the equivalent). Increased production will require increased capacity achieved in one way or another. The

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heart of the feasibility expenditure issue is whether and to what extent the cost of evaluating options for business growth is deductible. It is an issue that affects every business aspiring to grow."

That same article concludes:

"The court's … approach does not sit well with commercial realities. The approach reflects a restrictive view of business operations and unless readdressed by … Parliament, raises the risk of a revenue brake on business development and improvement which the country can scarcely afford."

Even the popular press have taken up the issue. Following the *Trustpower* decision the NBR wrote:[60]

"The big infrastructure companies are going to have to start putting pressure on the Minister of Revenue to get some legislation that makes it clear."

Likewise, the New Zealand Herald wrote:[61]

"Businesses have been left in limbo by the Supreme Court ruling in Trustpower's tax dispute."

Radio New Zealand commented:[62]

"Lawyers and accountants are warning a landmark ruling by the Supreme Court could deter big new business projects across New Zealand from getting started. The ruling means many of the huge costs in getting resource consent for projects cannot be set off against tax, making them more expensive. … Bridget McArthur is the chairwoman of the Energy Law Association and said the Supreme Court ruling could inhibit a lot of business enterprise."

Interestingly, most commentators noted that the decision may also pose "a big problem for government" which obviously favours these infrastructure projects to proceed.[63]

"What this decision does is potentially make a lot of costs that we thought were deductible non-deductible, and that means the cost of investigating new assets or new businesses becomes more expensive."

Conclusion

The Supreme Court has spoken and Inland Revenue must apply *Trustpower*. Due to the timing of the Supreme Court judgment some taxpayers will have already filed their 2015 income tax return while others will not. Presumably that will mean taxpayers who took their tax position based on IS 08/02 may have obtained a benefit over taxpayers who must apply the Supreme Court reasoning. That inconsistency is unwelcome.

Businesses often incur feasibility costs. It's part of being productive and innovative. Those costs should be deductible or depreciable, depending on the outcome — which was the "pragmatic approach" adopted by the taxpayer in *Milburn*.

Taxpayers potentially affected by the unsatisfactory outcome in *Trustpower* and the other cases may considering holding back on economically desirable large development projects. *Trustpower* has made a bad situation worse. After so many years and many unsatisfactory disputes it is now up to Parliament to resolve the problem. Options include widening the types of assets which qualify for depreciation, or allowing either an immediate deduction or Australian-type amortisation for expenditure that is written off for accounting purposes. But it is apparent that a legislative response is required to remedy the negative implications of these recent cases.

Footnotes

1 *Trustpower Ltd* v *Commissioner of Inland Revenue* [2016] NZSC 91, (2016) 27 NZTC ¶22-061.

2 Prohibited from deduction under s DA 2(1) Income Tax Act 2007.

3 James Coleman "Black Hole Expenditure" (June 2013) at http://www.jhcoleman.co.nz/articles/black_hole_expenditure/>.

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4 *ANZCO Foods Ltd* v *CIR* (2016) 27 NZTC ¶22-049.

5 *Queenstown Airport Corporation Ltd* v *C of IR HC Wellington*, (2016) 27 NZTC ¶22-054.

6 See *Trustpower*, SC, at [7].

7 See *Milburn NZ Ltd* v *CIR* (2001) 20 NZTC 17,017 (HC).

8 IS 08/02, at [18].

9 IS 08/02, at [20].

10 *Trustpower Ltd* v *CIR* (2013) 26 NZTC ¶21-047.

11 *CIR* v *Trustpower Ltd* (2015) 27 NZTC ¶22-010.

12 *BP Australia Ltd* v *Federal Commissioner of Taxation* [1966] AC 224 (PC).

13 *Trustpower*, CA, at [136].

14 Leave to appeal granted in *Trustpower Ltd* v *CIR* (2016) 27 NZTC ¶22-025.

15 *Trustpower, Ltd* v *CIR* (2016) 27 NZTC ¶22-061.

16 *Trustpower*, SC, at [71].

17 *Trustpower*, SC, at [65].

18 *Trustpower*, SC, at [25].

19 *Trustpower*, SC, at [48].

20 *Trustpower*, SC, at [70].

21 See http://www.ird.govt.nz/technical-tax/case-notes/2016/cn-2016-07-27-trustpower-cir.html>.

22 See http://www.ird.govt.nz/resources/1/6/1684cbc6-2d95-4e62-848a-12bdbdf29752/pub00278.pdf

23 See Tax Administration Act 1994, at ss 120W and 141B(1D); and the discussion in Mark Keating and Kirsty Keating "*Commissioner's Official Opinion: A "Get Out of Gaol Free" Card?*" (2015) 21 NZJTLP 270.

24 See Dean Mackenzie "Trustpower bemoans tax treatment decision" *Otago Daily Times* (online ed, Otago, 27 July 2016). at: http://www.odt.co.nz/news/business/391755/trustpower-bemoans-tax-treatment-decision.

25 *ANZCO Foods Ltd* v *CIR* (2016) 27 NZTC ¶22-049 (HC).

26 Within sch 14 Income Tax Act 2007.

27 *ANZCO Foods*, at [106].

28 *ANZCO Foods*, at [109].

29 *Queenstown Airport Corporation Ltd* v *CIR* (2016) 27 NZTC (HC) ¶22-054.

30 Within sch 13 Income Tax Act 2007.

31 *Queenstown Airport Corporation*, at [60].

32 *Queenstown Airport Corporation*, at [164].

33 James Coleman "Black Hole Expenditure" (June 2013) http://www.jhcoleman.co.nz/articles/black_hole_expenditure/.

34 See ss BC 4 and BC 5 Income Tax Act 2007.

35 James Coleman "Black Hole Expenditure" (June 2013) http://www.jhcoleman.co.nz/articles/black_hole_expenditure/.

36 See Inland Revenue "Regulatory Impact Statement – GST current issues" (11 February 2016) Tax Policy, Inland Revenue http://taxpolicy.ird.govt.nz/publications/2016-ris-archcrm-bill/gst-current-issues

37 Those reforms are included in the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Bill introduced on 3 May 2016.

38 IRD Regulatory Impact Statement — Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Bill , GST current issues, at: http://taxpolicy.ird.govt.nz/publications/2016-ris-archcrm-bill/gst-current-issues

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39 Inland Revenue “Regulatory Impact Statement – GST current issues” Tax Policy, Inland Revenue (11 February 2016) http://taxpolicy.ird.govt.nz/publications/2016-ris-archcrm-bill/gst-current-issues, at [22] and [26].

40 See Casey Plunket “Feasibility and Acquisition Expenditure – thoughts inspired by Milburn NZ Ltd and Recent Legislative changes” (2001) Chapman Tripp publications; and “Black hole disappointment”, Kevin Donaldson, Deloitte Tax Alert. See: http://nztaxonline.deloitte.co.nz/news/print.aspx?gid=1.

41 Craig Elliffe and Peggy Lui “The Problem with “Black Hole” and Feasibility Expenditure: Some Suggestions for Reform” (2011) 17 NZJTLP 67.

42 Rob O’Neill “Tax black hole threatens project plans” *The Sunday Star Times* (New Zealand, 4 July 2010).

43 NZICA “Black Hole R&D Expenditure Proposals” (20 Dec 2013) www.nzica.com/Technical/Tax/Tax-submissions/~/media/NZICA/Docs/

44 See New Zealand Government “Government Tax Policy Work Programme 2009-10” (20 March 2009), at: http://taxpolicy.ird.govt.nz/sites/default/files/news/2009-03-20-tpwp-2009-10.pdf at 2

45 Professor Adrian Sawyer “Complexity of Tax Simplification: A New Zealand Perspective” (January 2016), at: http://www.researchgate.net/publication/303442604_Complexity_of_Tax_Simplification_A_New_Zealand_Perspective

46 Milburn NZ Ltd v CIR (2001) 20 NZTC 17,017.

47 This change, which was recognized as “not complete”, was noted by the Supreme Court in Trustpower, SC, at [30] “Black hole R&D expenditure”, (Nov 2013) http://taxpolicy.ird.govt.nz/sites/default/files/2013-dd-black-hole-r-and-d-expenditure.pdf at 1.1-1.3.

48 “Black hole R&D expenditure”, (Nov 2013) http://taxpolicy.ird.govt.nz/sites/default/files/2013-dd-black-hole-r-and-d-expenditure.pdf at 1.1-1.3.

49 See Hon Peter Dunne, “Budget Tax Relief for ‘black hole’ expenditure”, (15 May 2013), at: http://www.beehive.govt.nz/release/budget-tax-relief-%E2%80%98black-hole%E2%80%99-expenditure. See also: Inland Revenue “Black hole expenditure” (November 2013) Tax Policy, Inland Revenue http://taxpolicy.ird.govt.nz/publications/2013-commentary-arearm/black-hole-expenditure.

50 Inland Revenue “Black hole expenditure (February 2015) Tax Policy, Inland Revenue http://taxpolicy.ird.govt.nz/publications/2015-commentary-arrdrm/black-hole-expenditure.

51 Inland Revenue “Black hole expenditure” (November 2013) Tax Policy, Inland Revenue http://taxpolicy.ird.govt.nz/publications/2013-commentary-arearm/black-hole-expenditure.

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53 James Coleman “Black Hole Expenditure” (June 2013), at http://www.jhcoleman.co.nz/articles/black_hole_expenditure/>.

54 See Commonwealth Tax Laws Amendment (2006 Measures No. 1) Act 2006.

55 Business Tax Review, (July 2006) Inland Revenue http://taxpolicy.ird.govt.nz/sites/default/files/2006-dd-btr.pdf at [3.33].

56 Brendan Brown “The Capital-Revenue Boundary: Legislative Developments and Interpretative Issues” (2013) Chartered Accountants Australia New Zealand, at: http://www.nzica.com/~/media/NZICA/Docs/Resources%20and%20publications/2013%20Tax%20Conference/TC13%20Brendan%20Brown%20paper.ashx.

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60 Jenny Ruth “Trustpower case creates ‘black hole expenditure’” National Business Review at: http://www.nbr.co.nz/article/trustpower-case-creates-black-hole-expenditure-jr-p-175072.

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61 Hamish Fletcher “Trustpower tax ruling creates uncertainty” *The New Zealand Herald* (28 July 2016)

62 Eric Frykberg “Concern tax ruling may hurt development” (28 July 2016) Radio NZ, at http://www.radionz.co.nz/news/business/309597/concern-tax-ruling-may-hurt-development

63 Eric Frykberg “Concern tax ruling may hurt development” (28 July 2016) Radio NZ, at http://www.radionz.co.nz/news/business/309597/concern-tax-ruling-may-hurt-development

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