

19 July 2017

Black Hole and Feasibility Expenditure Proposals
C/- Deputy Commissioner, Policy and Strategy
Inland Revenue Department
PO Box 2198
Wellington 6140

Dear Deputy Commissioner

Re: Black Hole and Feasibility Expenditure Discussion Document

I am writing to you regarding the discussion document released by Inland Revenue on 25 May entitled '*Black Hole and Feasibility Expenditure*' (referred to as "the Document").

Background

BusinessNZ wrote to both the Minister of Finance and Minister of Economic Development in September 2016, expressing deep concern about the impact on the business community of the Supreme Court's judgment in the *Trustpower Limited v Commissioner of Inland Revenue*. We stated that the decision's impact would be far wider than in the above case which involved the cost of the resource consents needed to evaluate the feasibility of possible electricity generation projects. We believed the decision would have pervasive effect extending across a range of businesses and industries that invest in new functionality, capacity or capability.

Therefore, it is pleasing to see that after discussions with various interested parties in the private sector, Inland Revenue has released a Document to examine ways in which this issue might be rectified.

Overall, BusinessNZ is broadly supportive of the proposed changes. However, while we understand that others in the private sector will be submitting in detail on key aspects of the Document, we would like to provide some broader comments on three key areas.

Defining feasibility expenditure

Although Inland Revenue has previously been of the view that the term '*feasibility expenditure*' should not be defined, in light of events leading up to this point BusinessNZ is pleased to see that there is now a move towards providing a definition. At the same time, we also accept the Document's statement that '*creating an appropriate definition is the most challenging aspect of this proposal*'.

We note that Inland Revenue's working definition as outlined in paragraph 3.8 is '*expenditure to determine the practicability of a proposal, prior to commitment to developing the proposal*', which in essence is more restrictive than the common understanding of feasibility expenditure, namely '*expenditure incurred by a taxpayer for determining the practicality of a new proposal*'. Paragraph 3.12 then proceeds to outline what would be excluded, primarily based on expenditure that would form part of the cost of depreciable property if the proposal is successful. Expenditure for which any black hole treatment has already been remedied under the Income Tax Act 2007 is also excluded.

BusinessNZ believes that for any new definition to be successful and capture the correct amount of feasibility expenditure, it is critical that it is not overly prescriptive, restricting the ability of businesses to deduct and leading to an increase in compliance costs. While we accept that a too-wide definition would unsettle existing economically efficient capital/revenue tax law, the new definition still has to be workable and practicable from a business perspective. Overall, we take the view that while the first part of the revised definition is workable, the second part that outlines a commitment to develop the proposal may narrow the test for feasibility expenditure too much. Therefore, we believe the starting point should be one that does not include a commitment criteria.

Recommendation: That Inland Revenue develops a less restrictive definition of feasibility expenditure.

On the above point, the effectiveness of a new definition can only be as good as it is when put into practice. Ideally, there should be little if any scope for confusion when the definition is applied to real-world examples. Then the business community can have a high degree of certainty of what feasibility expenditure will cover and what it will exclude.

BusinessNZ believes Inland Revenue should set out a range of examples where expenditure will or will not meet the stated criteria.

Recommendation: That Inland Revenue set out a range of examples where expenditure will or will not meet the stated criteria for feasibility expenditure.

International Financial Reporting Standards (IFRS) Treatment

BusinessNZ supports the proposal for businesses to apply IFRS to expenditure that meets a new definition of feasibility expenditure, as modified by our recommendation above. We consider this is a simple and equitable way to address the area of black hole and feasibility expenditure, and in particular the current uncertainties.

However, we consider that the IFRS treatment of such expenditure should be adopted in full, with no further exclusions. In particular, we believe a deduction should be available for partial impairment of an asset where a consistent treatment is applied under IFRS. We consider that sufficient exclusions and restrictions exist under IFRS that simply requiring IFRS to be followed for both accounting and tax will result in an equitable outcome.

Recommendation: That Inland Revenue allow a deduction for partial impairment of an asset, provided an equivalent impairment loss is recognised under IFRS accounting standards.

De-Minimis

BusinessNZ supports the introduction of a de-minimis rule under which expenditure would be deductible if it complied with the general permission, was within the definition of 'feasibility expenditure' and was below a particular de minimis threshold. Overall, this would be a proactive way to reduce compliance costs for businesses that incur relatively little feasibility expenditure, particularly in circumstances where they do not use IFRS to prepare financial statements. BusinessNZ submits that the de-minimis threshold should be measured on the basis of external costs (i.e. the cost of employees and shareholders considering feasibility proposals should not be included when calculating the de-minimis).

While the Document points out that a \$10,000 de-minimis threshold might be appropriate given one of that value already exists for legal and research and development expenditure, BusinessNZ would not object to a higher threshold if other submitters outlined practical reasons why a higher threshold would be justified.

Recommendation: That Inland Revenue introduce a de-minimis threshold of at least \$10,000 under which expenditure would be deductible if it complied with the general permission.

Application date

In paragraph 3.38, the Document points to a number of possible dates for the application of the main proposals. These include the option of any change applying from the date of the *Trustpower* decision.

BusinessNZ has strong sympathy for this option, given the simple fact that the legal test in the *Trustpower* decision was more restrictive than Inland Revenue's original interpretation. In turn, this means there is general consensus across both the private

and public sectors that the current treatment is now unsatisfactory from a country perspective. Therefore, it makes sense that the proposals should to the extent possible eliminate the impact of the *Trustpower* decision.

In our view, some form of retrospectivity is warranted as the *Trustpower* decision effectively changed the law through a change in interpretation, and it would be unfair for businesses currently incurring feasibility expenditure to be 'worse off' than those that have delayed incurring such expenditure until the proposals are enacted.

Therefore, BusinessNZ recommends a retrospective application date back to 27 July 2016, the date of the Supreme Court judgment in the *Trustpower* case.

Also, to ensure we get back on an even keel of simplicity and certainty for the business community, we would like to see existing Inland Revenue reviews given some leeway. We accept the fact that Inland Revenue cannot act on the basis of the discussion document since there has as yet been no actual law change and the application date is uncertain. However, one could rightly argue that the events leading to this situation are very different from those that ordinarily lead to an Inland Revenue investigation, subsequently causing the Department to engage in consultation. Realistically, there is a high probability that resources would be wasted on decision-making that to all intents and purposes would either have to change or be seen as being far from fair.

Recommendation: That Inland Revenue apply changes from the date of the Trustpower decision, namely 26 July 2016.

Thank you for your time, and we look forward to further developments in this space.

Kind regards,

A handwritten signature in black ink, appearing to be 'Kirk Hope', written in a cursive style.

Kirk Hope
Chief Executive
BusinessNZ