BusinessNZ
GROWING PROSPERITY AND POTENTIAL

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Feasibility and non-deductible "black hole" expenditure: detailed design
Inland Revenue Department
PO Box 2198
Wellington 6140

Dear Sir/Madam

Re: Feasibility and non-deductible "black hole" expenditure: detailed design

I am writing to you regarding the document we received from Inland Revenue on 11 November entitled *'Feasibility and non-deductible "black hole" expenditure: detailed design'* (referred to as "the Document").

Background
BusinessNZ has previously taken the opportunity to discuss the issues of feasibility and non-deductible 'black hole' expenditure with the Government, including both issues relating to the Trustpower Supreme Court decision and the Black Hole and Feasibility Expenditure discussion document released in 2017. We also supported the announcement by the Government on 23 September in which the Government declared its intention to reform the tax treatment of expenditure incurred by businesses when developing assets that decline in value.

Overarching comments
Overall, BusinessNZ is broadly supportive of the proposed changes outlined in the Document. However, we are also cognisant of the fact that while it is good to see this issue on the Government's policy agenda, it is also important that the policies themselves are not found to be either overcomplicated or miss the mark in terms of its intended focus. If this was the case, ultimately it would undo much of the good work introducing them in the first place.

First, we believe what is proposed could be viewed as quite a narrow fix, given it is mainly for one type of black hole expenditure. Therefore, the Government needs to be very clear as to what this Document is intended to address to avoid any misunderstanding. For example, the Document is heavily focused around depreciable assets, but in reality that is just one element of feasibility expenditure/black hole expenditure.

Also, the Document seems more focused around a business that is self-constructing a new asset rather than doing broader analysis around growing their business. For example, a business might want to evaluate whether it builds a new power station, or whether it buys the power station off a competitor. If they are allowed to just buy the power station asset they can claim a deduction if it all fails. However, if they are told they have to buy the company that the power station asset is sitting in – and it then falls through - then there are no deductions available because they were looking at buying shares rather than assets. This is despite the fact that for all intents and purposes, the two options were essentially the same thing, namely the objective of wanting to grow the business.

Last, as the Document currently stands, if no attempt is made to address how the design can be widened, there will most likely be ongoing and persistent calls from the business sector to address such concerns.

Detailed questions examined

We understand that others in the private sector will be submitting in detail on key aspects of the detailed design. Therefore, BusinessNZ would like to provide some broader comments on the four key questions asked in the Document.

Timing of the deduction

The Document outlines two options as to when the deduction should be available, namely:

1. The deduction is available for the income year in which the expenditure is incurred; or
2. The deduction is available for the income year in which the business decides not to proceed with the asset.

If we were just to look at these two options in isolation, we believe the Document outlines a number of pertinent points for both options that need to be taken into account. However, we believe that option 1 does not address the greater compliance cost implications for businesses, which would run contrary to the view expressed in the Document that option 1 could be simple in operation. Combining this with the fact that robust reinstatement rules would also be required, we believe option 2 would be a better fit going forward.

However, another option that we understand other submitters will discuss involves some type of half-way house between the two options discussed in the Document. Given we are keen to ensure the timing of the deduction is as simple to understand

and least disruptive as possible, BusinessNZ recommends that Inland Revenue should consider options beyond the two put forward.

Recommendation: That Inland Revenue also consider alternative options regarding the timing of the deduction.

Reinstatement of earlier deducted expenditure

Fundamentally, BusinessNZ agrees that a reinstatement requirement is necessary for integrity reasons associated with earlier deducted expenditure. We would not want a situation where the proposal is not compatible with existing law regarding the low value asset write off or disposal.

However, at the same time it is important that the possibility of claimed deductions that are clawed back does not have an undue influence on whether a business pursues a previously abandoned project if it comes with a very high upfront tax cost. We understand other submitters will be canvassing some of the implications of this, including the fundamental question around what the $10,000 de minimis rule is intended to do? In short, we would want any outcome to allow a balance between pragmatism and the most compliance cost friendly approach possible.

Recommendation: That Inland Revenue seek a balance between the most pragmatic and compliance cost light option when looking to address reinstatement of earlier deducted expenditure.

Start-ups and SME sized businesses

BusinessNZ agrees that IRD's interpretation statement IS 17/01 has both limited application for start-up companies, as well as SMEs most likely not being of the opinion that the statement deals with their particular circumstances. Therefore, we support the introduction of an immediate deduction for expenditure up to $10,000 incurred in developing business assets in an income year.

Furthermore, as pointed out in our submission in 2017, 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.

Other Matters

Page 1 of the Document states that *'if the Government chooses to proceed with the proposal, amending legislation would be included in the first taxation bill introduced into Parliament in 2020, and intended to apply to expenditure incurred from the start of the 200-21 income year'*. Given comments on this Document are due by 13 December, followed by Xmas break, it provides relatively little time from a policy perspective to ensure the correct legislation is drafted in time for the first Taxation Bill in 2020. History has shown that despite best intentions, the draft legislation in a Bill can be markedly different from what has been expected. Furthermore, getting substantive changes made in the Bill once before Select Committee can also be very hard to achieve.

To minimise this risk, we believe it would be very worthwhile for Inland Revenue to release an exposure draft bill that just focuses on the feasibility and non-deductible "black hole" expenditure legislation. That way, any potential unintended consequences regarding draft legislation can be minimised.

Recommendation: That Inland Revenue release an exposure draft bill that just focuses on the feasibility and non-deductible "black hole" expenditure legislation.

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

Kind regards,

Steve Summers
Economist
BusinessNZ