Inland Revenue
Te Tari Taake

TECHNICAL DECISION SUMMARY > PRIVATE RULING

WHAKARĀPOPOTO WHAKATAU HANGARAU > WHAKATAUNGA TŪMATAITI

Depreciation loss on asset no longer used

Decision date | Rā o te Whakatau: 2 September 2024

Issue date | Rā Tuku: 5 December 2024

TDS 24/23

Subjects | Kaupapa

Depreciation loss, general permission, general limitation, asset no longer used

Taxation laws | Ture tāke

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

Summary of facts | Whakarāpopoto o Meka

1. The Taxpayer was a company that had shut down a part of their business. This was not a cessation of business activity, rather a change in business direction.
2. The change in direction meant an asset it had could no longer be used in that new business. The asset remained onsite. Neither the Taxpayer nor its associates could use it in their business given the nature of the asset.
3. The Taxpayer obtained an independent report on the costs to dispose of the asset. This report found that these costs would exceed any scrap value consideration that could be derived on disposal.
4. The Taxpayer sought a ruling from the Tax Counsel Office (TCO) that they had a depreciation loss for the income year under s EE 39 (items no longer used).

Issues | Take

5. The main issue considered in this ruling was:
   - Whether the Taxpayer had an amount of depreciation loss for the relevant income year under s EE 39.
6. This ruling did not consider or rule on the potential application of the disposal provisions in ss EE 44 – EE 52 for future income years.

Decisions | Whakatau

7. TCO concluded that under s EE 39, provided that no provision in subparts DB to DZ applied to modify or deny the depreciation deduction:
   - The Taxpayer had a depreciation loss for the income year equal to the adjusted tax value of the asset at the start of its income year per subs (5).

- No other amount of depreciation loss arose under subpart EE in relation to the asset in the income year per subs (3).
- The adjusted tax value of the asset in the Taxpayer's fixed asset register at the end of the income year is zero per subs (6).

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: Depreciation loss on asset no longer used

8. Section EE 1 sets out the criteria for claiming a depreciation loss. TCO noted that the Taxpayer met the first three criteria in s EE 1 – the property was owned by them within the meaning of ss EE 2 to EE 5, the asset was depreciable property as defined in s EE 6 and it was available for use in the income year until the change in business direction occurred. TCO considered the general permission, general limitations and the calculation of that loss next.

General permission and general limitations

9. To claim a depreciation loss, TCO noted that the Taxpayer needed to have incurred the loss in the course of carrying on a business in deriving their income (s DA 1(1)(b), the second limb of the general permission). There must be a nexus between the expenditure and the business that is being carried on for the expenditure or loss to be deductible.[1] TCO considered the Taxpayer satisfied the general permission as it was in business throughout the relevant income year, and the depreciation loss was incurred in the course of its business as the asset was part of their business structure and income earning process until the change in direction.

10. Section DA 2 contains several general limitations that override s DA 1 (the general permission). TCO considered that none of these limitations applied to override the general permission, and more specifically the capital limitation in s DA 2(1) did not apply to an amount of depreciation loss merely because the item of property is itself of a capital nature (s DA 4).

[1] *CIR v Banks* (1978) 3 NZTC 61,236 (CA) and *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271 (CA)), *NRS Media Holdings v C of IR* (2018) 28 NZTC 30,328).

11. Under s DA 3(6), no provision in Part E (Timing and quantifying rules) overrides the general permission or a general limitation, so no provision in subpart EE affects TCO's conclusion that the general permission is satisfied, and no general limitations apply.

12. TCO did not consider every provision of Part D so, out of caution, they included the proviso that subparts DB to DZ did not apply to modify the deduction for depreciation loss calculated under s EE 39.

Asset no longer used

13. Having concluded that the general requirements to claim a depreciation loss were satisfied, TCO turned their mind to the final requirement being the amount of depreciation loss to be calculated in accordance with s EE 9 (description of elements of calculation), which refers to the application of s EE 39 (items no longer used).

14. The Taxpayer needed to satisfy the following conditions for s EE 39 to apply:

- The asset is no longer used in an income year.
- The asset is not a building.
- The asset has not been depreciated using the pool method.
- The asset is no longer, nor is intended to be, used in deriving assessable income or carrying on a business by the Taxpayer or associated persons.
- The cost of disposing of the asset would be more than any consideration the Taxpayer could get from disposing of it.

15. TCO considered the first four bullet points were met by the Taxpayer as they concerned factual matters or the Taxpayer's intention and were addressed by including conditions to the ruling.

16. TCO considered further whether the cost of disposal would be more than the consideration the Taxpayer could get from disposing of it (s EE 39(4)(c)). Particular to this inquiry was the meaning of "dispose", "consideration" and "could" in this context as follows:

- "Dispose" means to "get rid of"[2], and includes destroying, withdrawing, or letting lapse (s YA 1), and in relation to ownership of an item, includes situations where a person who is the legal or equitable owner of an item of property deals with

[2] *Concise Oxford English Dictionary* (12th Edition).

the property in such a way that the person is no longer that owner (which would include selling the property).[3]

- Section EE 47 details a number of events similar to "disposal" such as where there is a change of use or location of use, loss or theft, irreparable damage to an item of property or a building, or permanent removal of the property from New Zealand.
- Section EE 45 provides that "consideration" is the amount a person derives less (disposal) costs and may be a zero or negative amount, as modified by subss (3) to (11). As s EE 39(4)(c) refers to the comparison of "consideration" with the "costs of disposing", TCO said that "consideration" in s EE 39 did not include disposal costs as that would result in double counting. TCO concluded that "consideration" in this context is the amount a person derives on disposal as modified by ss EE 45(3) – EE 45(11) (if applicable).
- TCO noted that the ordinary meaning of "could" suggests that to satisfy s EE 39(4)(c), the costs to dispose of the asset needs to be more than any amount the Taxpayer has a hypothetical objective possibility or opportunity in the conditions of its case of deriving from disposing of the asset.[4]

17. Having considered the plain and ordinary meaning of the statutory text, TCO cross checked the ordinary meaning with the legislative purpose.[5]

18. TCO said that the predecessor legislation and extrinsic material supported the view that the criterion in s EE 39(4)(c) was intended to be assessed on an objective basis based on the best estimate of the costs of disposal and potential sale or disposal proceeds for the particular asset.[6] TCO stated for the Taxpayer to satisfy s EE 39(4)(c), the costs for them to destroy, sell, or get rid of the asset needs to be more than the amount that they had the objective possibility or opportunity of deriving from its disposal. It was also implicit from the legislative context that s EE 39 cannot apply if the asset had already been disposed of during the relevant income year. TCO was satisfied that the Taxpayer had not disposed of the asset in the relevant income year.

19. TCO found that the final requirement for s EE 39 to apply was satisfied, that is, the cost of disposal would exceed any consideration the Taxpayer could get from disposal as:

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[3] From the context of the meaning of "own" in s EE 2, and the reference to "disposed of" in s EE 1(3)(c).

[4] *Oxford English Dictionary* (online edition).

[5] Section 10 of the Legislation Act 2019.

[6] See, for example, section 108K(6) on the Income Tax Act 1976; section EG 12(6) of the Income Tax Act 1994; the Taxation (Annual Rates, Taxpayer Assessment and Miscellaneous Provisions) Act 2001 and its related Bill Commentary.

- According to an independent report, the estimated cost to dispose of the asset was greater than the estimated scrap value that could be derived.
- While the asset was considered marketable, due to the unique nature of the asset, there was an absence of buyers and lack of a market or opportunities for sale. The asset was marketed for sale and the Taxpayer did not receive any offers to purchase it. There were interested parties, but this did not progress beyond an initial inquiry. This supported an objective assessment that the best estimate of the consideration that could be received from disposing the asset was the scrap value, which per above, was less than the cost of disposal.

20. Having concluded that the Taxpayer satisfied all the requirements for s EE 39 to apply (as listed at [15]), TCO said that under s EE 39(5) the amount of the Taxpayer's depreciation loss was the adjusted tax value of the asset at the start of their income year as calculated by applying ss EE 55 to EE 60 and the adjusted tax value of the asset in the Taxpayer's fixed asset register at the end of the income year is zero per subs (6).