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TAX INFORMATION Bulletin

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Ref	Draft type	Title	Comment deadline
PUB00459	Question we've been asked	Income tax: Can I claim a deduction for expenses I incur on repairing a recently acquired capital asset?	28 March 2025

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IN SUMMARY

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NEW LEGISLATION

This section of the *TIB* covers new legislation, changes to legislation including general and remedial amendments, and Orders in Council.

Taxation (Use of Money Interest Rates) Amendment Regulations 2024

Issued: 12/02/2025

SL 2024/254

Changes have been made by Order in Council to the use of money interest rates on underpayments or overpayments of tax in line with recent changes in market interest rates.

Order

Sections 120E and 120H of the Tax Administration Act 1994

The Taxation (Use of Money Interest Rates) Amendment Regulations 2024 was made on 9 December 2024. The Order in Council changes the use of money interest (UOMI) rate on underpayments and overpayments of taxes and duties in line with market interest rates.

The new underpayment rate is 10.88% (previously 10.91%). The new overpayment rate is 4.30% (previously 4.67%).

Background

The UOMI underpayment rate is charged to taxpayers on underpayments of tax to Inland Revenue, while the UOMI overpayment rate is paid to taxpayers on money paid to Inland Revenue exceeding their tax liability.

Section 120H(1)(b) of the Tax Administration Act 1994 permits the making of regulations by Order in Council to set the UOMI underpayment and overpayment rates. Once a rate is set, it remains at that rate until changed by a subsequent Order in Council.

The UOMI underpayment rate is based on the 'floating first mortgage new customer housing rate' series published by the Reserve Bank (RBNZ) each month, while the UOMI overpayment rate is based on RBNZ's '90-day bank bill rate' series each month. The UOMI rates are both adjusted if either the RBNZ 90-day bank bill rate or the floating first mortgage new customer housing rate moves by 1% or more, or if one of these indexes moves by 0.2% or more and the UOMI rates have not been adjusted in the last 12 months.

The UOMI rates are adjusted as required to ensure they are in line with market interest rates. The new UOMI underpayment and overpayment rates are consistent with the floating first mortgage new customer housing rate and the 90-day bank bill rate.

Effective date

The new UOMI underpayment and overpayment rates apply on and after 16 January 2025.

Further information

The new regulations can be found at:

Taxation (Use of Money Interest Rates) Amendment Regulations 2024

LEGISLATION AND DETERMINATIONS

This section of the *TIB* covers items such as recent tax legislation and depreciation determinations, livestock values and changes in FBT and GST interest rates.

FDR 2025/01: Determination under section 91AAO of the Tax Administration Act 1994 that investors in JPM Aggregate Bond - NZD Hedged Dividend Class X Shares may not use the fair dividend rate method to calculate FIF income

Any investment by a New Zealand resident investor in shares in the JPM Aggregate Bond Fund ("the Fund") – NZD Hedged Dividend Class X shares, to which none of the exemptions in sections EX 29 to 43 of the Income Tax Act 2007 apply, is a type of attributing interest for which the investor may not use the Fair Dividend Rate ("FDR") method to calculate Foreign Investment Fund income for the interest.

Reference

This determination is made under section 91AAO(1)(b) of the Tax Administration Act 1994. This power has been delegated by the Commissioner of Inland Revenue to the position of Technical Specialist, under section 7 of the Tax Administration Act 1994.

Discussion (which does not form part of the determination)

Shares in the New Zealand Dollar (NZD) denominated class of the JPMorgan Funds - Aggregate Bond Fund ("the Fund"), a Luxembourg Managed Investment Scheme, are an attributing interest in a foreign investment fund ("FIF") for New Zealand resident investors when none of the exemptions in section EX 29 to EX 43 of the Income Tax Act 2007 apply. The Fund is part of The JPMorgan Funds and incorporated under the laws of Luxembourg.

The Fund is part of a range of sub-funds within a Luxembourg domiciled Managed Investment Scheme and is operated with separate classes of shares. These sub-funds do not have a separate legal personality.

New Zealand resident investors are required to apply the FIF rules to determine their tax liability in respect of their investment in shares in the NZD denominated class of the Fund ("the NZD Share Class") each year.

The Fund invests in a portfolio of international fixed interest securities (global bonds) and other financial arrangements. The Fund has on issue a number of share classes including a class of shares denominated in New Zealand dollars ("NZD Hedged Class") that provide holders of that class of units with an interest in the pool of investments held by the Fund. Foreign currency hedging arrangements are in place which effectively provide investors in the NZD Hedged Class with a New Zealand dollar denominated return on the financial arrangements held by the Fund.

Section EX 46(10)(c) of the Income Tax Act 2007 would not apply to prevent the use of the fair dividend rate ("FDR") method for interests in the NZD Share Class but would apply if the Fund represented a separate foreign company and the NZD Share Class was the only class of share on issue on issue.

The policy intention is that the FDR method of calculating FIF income should not be applied to investments that provide a New Zealand resident investor with a return similar to a New Zealand dollar denominated debt investment. It is appropriate for the Commissioner to take into account the whole of the arrangement including any interposed entities or financial arrangements in ascertaining whether an investment in a FIF provides the New Zealand-resident investor with a return akin to a New Zealand dollar denominated debt investment.

On this basis, where a New Zealand resident invests in the NZD Hedged Class units issued by the Fund, I consider that it is appropriate for the investor holding that investment to be excluded from using the FDR method.

Scope of determination

This determination is issued on the basis of information provided to the Commissioner before the date of this determination and applies to an attributing interest in a FIF held by New Zealand resident investors in a non-resident issuer where:

1. The non-resident issuer:
    - is a Luxembourg Managed Investment Scheme;
    - is known at the date of this determination as JPMorgan Funds - Aggregate Bond Fund; and
    - is operated with separate classes of shares.
2. The attributing interest consists of the New Zealand dollar denominated class of units issued in JPM Aggregate Bond - NZD Hedged dividend Share Class X, a class of units that provides exposure solely to JPMorgan Funds - Aggregate Bond Fund that predominantly (i.e. 80% or more by value at a time in the income year) holds financial arrangements such as international fixed interest securities (global bonds); and
3. The investment assets attributable to the New Zealand dollar denominated class of units are subject to foreign currency hedging arrangements undertaken by the non-resident issuer for the purpose of eliminating exchange rate risk for New Zealand investors on a highly effective basis. In practise the hedging ranges employed by the NZD Hedged Class units are typically 95%-105% of foreign currency risk for the assets.

Conditions

It is a condition of this determination that the investment in the Fund is part of an overall arrangement that seeks to provide the New Zealand resident investor with a return that is economically equivalent to a debt instrument denominated in New Zealand dollars.

In addition, it is a condition of this determination that an investor will not be excluded from using the FDR method to calculate FIF income from an interest where the absolute notional value of the Fund's investment in global fixed income securities (directly or indirectly via derivatives) plus the fair value of the related hedges plus cash and cash equivalents (together referred to as "the numerator") is 80% or less than the combined total of the numerator plus the absolute nominal value of other derivatives (together referred to as "the denominator") for a continuous period of 45 days. For the purposes of calculating the numerator and denominator hedging to NZD is excluded. Should this occur, the determination will cease to apply from the first day of the quarter immediately following the expiry of the 45-day period.

Interpretation

In this determination unless the context otherwise requires:

"Fair dividend rate method" means the fair dividend rate method under section YA 1 of the Income Tax Act 2007;

"Financial arrangement" means financial arrangement under section EW 3 of the Income Tax Act 2007;

"Foreign investment fund" means foreign investment fund under section YA 1 of the Income Tax Act 2007;

"New Zealand resident" means a person that is resident in New Zealand for the purposes of the Income Tax Act 2007;

"Non-resident" means a person that is not resident in New Zealand for the purposes of the Income Tax Act 2007;

"The Fund" means the JPMorgan Aggregate Bond Fund, a sub-fund of JPMorgan Funds.

Determination

An attributing interest in a FIF to which this determination applies is a type of attributing interest for which a person may not use the FDR method to calculate FIF income from the interest.

Application Date

This determination applies for the 2024-25 income year and subsequent income years.

However, under section 91AAO(3B) of the Tax Administration Act 1994, this determination does not apply for a person and an income year beginning before the date of the determination unless the person chooses that the determination applies for the income year.

Dated this day of 29 January 2025

Iain McConville

Technical Specialist

FDR 2025/02: Determination the fair dividend rate method may not be used to calculate FIF income by investors in the iShares Core Global Aggregate Bond UCITS ETF – NZD hedged (Accumulating) share class

Any investment by a New Zealand resident investor in the NZD hedged (Accumulating) share class of the iShares Core Global Aggregate Bond UCITS ETF, a sub-fund of iShares III public limited company, to which none of the exemptions in sections EX 29 to 43 of the Income Tax Act 2007 apply, is a type of attributing interest for which the investor may not use the fair dividend rate (**"FDR"**) method to calculate foreign investment fund income for the interest.

Reference

This determination is made under section 91AAO(1)(b) of the Tax Administration Act 1994. This power has been delegated by the Commissioner of Inland Revenue to the position of Technical Specialist under section 7 of the Tax Administration Act 1994.

Discussion (which does not form part of the determination)

Shares in the NZD hedged (Accumulating) class (**"NZD Class"**) of iShares Core Global Aggregate Bond UCITS ETF (**"Core Global"**), are an attributing interest in a foreign investment fund (**"FIF"**) for New Zealand resident investors when none of the exemptions in sections EX 29 to EX 43 of the Income Tax Act 2007 apply. Core Global is a sub-fund of iShares III public limited company incorporated under the laws of Ireland. iShares III is structured as an umbrella fund with segregated liability between sub-funds. These sub-funds do not have a separate legal personality.

New Zealand resident investors are required to apply the FIF rules to determine their tax liability in respect of their investment in the NZD Class of Core Global each year.

Core Global invests in a portfolio of global fixed interest securities. Core Global has on issue several share classes that provide holders of that class with an interest in the pool of securities held by Core Global. The NZD Class of Core Global is denominated in New Zealand dollars. Foreign currency hedging arrangements are in place which effectively provide investors in the NZD Class of Core Global with a New Zealand dollar denominated return on the financial arrangements held by Core Global.

Section EX 46(10)(c) of the Income Tax Act 2007 does not apply to prevent the use of the FDR method for interests in the NZD class of Core Global given that Core Global does not have a distinct legal personality separate from iShares III. As such, the entire portfolio of iShares III public limited company is taken into consideration when examining whether the 80% test is satisfied. However, Section EX 46(10)(c) would apply to prevent the use of the FDR method if Core Global represented a separate foreign company and the NZD class was the only class of share on issue.

The policy intention is that the FDR method of calculating FIF income should not be applied to investments that provide a New Zealand resident investor with a return similar to a New Zealand dollar denominated debt investment. It is appropriate for the Commissioner to take into account the whole of the arrangement including any interposed entities or financial arrangements in ascertaining whether an investment in a FIF provides the New Zealand resident investor with a return akin to a New Zealand dollar denominated debt investment.

On that basis, where a New Zealand resident invests in the NZD Class of Core Global, I consider that it is appropriate for them to be excluded from using the FDR method.

Scope of determination

This determination is issued on the basis of information provided to the Commissioner before the date of this determination. It applies to an attributing interest in a FIF held by New Zealand resident investors in a non-resident issuer where:

- This non-resident issuer:
  - is incorporated in Ireland and issues multiple classes of shares; and
  - is known at the date of this determination as iShares III Public Limited Company; and
  - is structured as an umbrella fund with segregated liability between sub-funds.
- The attributing interest consists of the NZD hedged (Accumulating) class of share, issued in iShares Core Global Aggregate Bond UCITS ETF, a sub-fund of iShares III Public Limited Company. This class of shares provides exposure solely to a portfolio predominantly of fixed interest securities and other financial arrangements; and
- The investment assets attributable to the NZD hedged (Accumulating) class of share are subject to foreign currency hedging arrangements undertaken by the non-resident issuer for the purpose of eliminating to the extent possible any exchange rate risk for New Zealand investors where this removes 80% to 125% of foreign currency risk for the assets.

Interpretation

In this determination, unless the context otherwise requires –

"Fair dividend rate method" means the fair dividend rate method under section YA 1 of the Income Tax Act 2007;

"Financial arrangement" means financial arrangement under section EW 3 of the Income Tax Act 2007;

"Foreign investment fund" means foreign investment fund under section YA 1 of the Income Tax Act 2007;

"Non-resident" means a person that is not resident in New Zealand for the purposes of the Income Tax Act 2007;

"Core Global" means the iShares Core Global Aggregate Bond UCITS ETF, a sub-fund of iShares III Public Limited Company.

Determination

An attributing interest in a FIF to which this determination applies is a type of attributing interest for which a person may not use the fair dividend rate method to calculate FIF income from the interest.

Application Date

This determination applies for the 2024-2025 income year and subsequent income years.

Under section 91AAO(3B) of the Tax Administration Act 1994, this determination does not apply for a person and an income year beginning before the date of the determination unless the person chooses that the determination applies for the income year.

Dated on this 28th day of January 2025.

Iain McConville

Technical Specialist

INTERPRETATION STATEMENT

This section of the *TIB* contains interpretation statements issued by the Commissioner of Inland Revenue.

These statements set out the Commissioner's view on how the law applies to a particular set of circumstances when it is either not possible or not appropriate to issue a binding public ruling.

In most cases Inland Revenue will assess taxpayers in line with the following interpretation statements. However, our statutory duty is to make correct assessments, so we may not necessarily assess taxpayers on the basis of earlier advice if at the time of the assessment we consider that the earlier advice is not consistent with the law.

Some interpretation statements may be accompanied by a fact sheet summarising and explaining the main points. Any fact sheet should be read alongside its corresponding interpretation statement to completely understand the guidance. Fact sheets are not binding on the Commissioner. Check **taxtechnical.ird.govt.nz/publications** for any fact sheets accompanying an interpretation statement.

IS 25/03: Income tax – identifying the relevant item of property for depreciation purposes

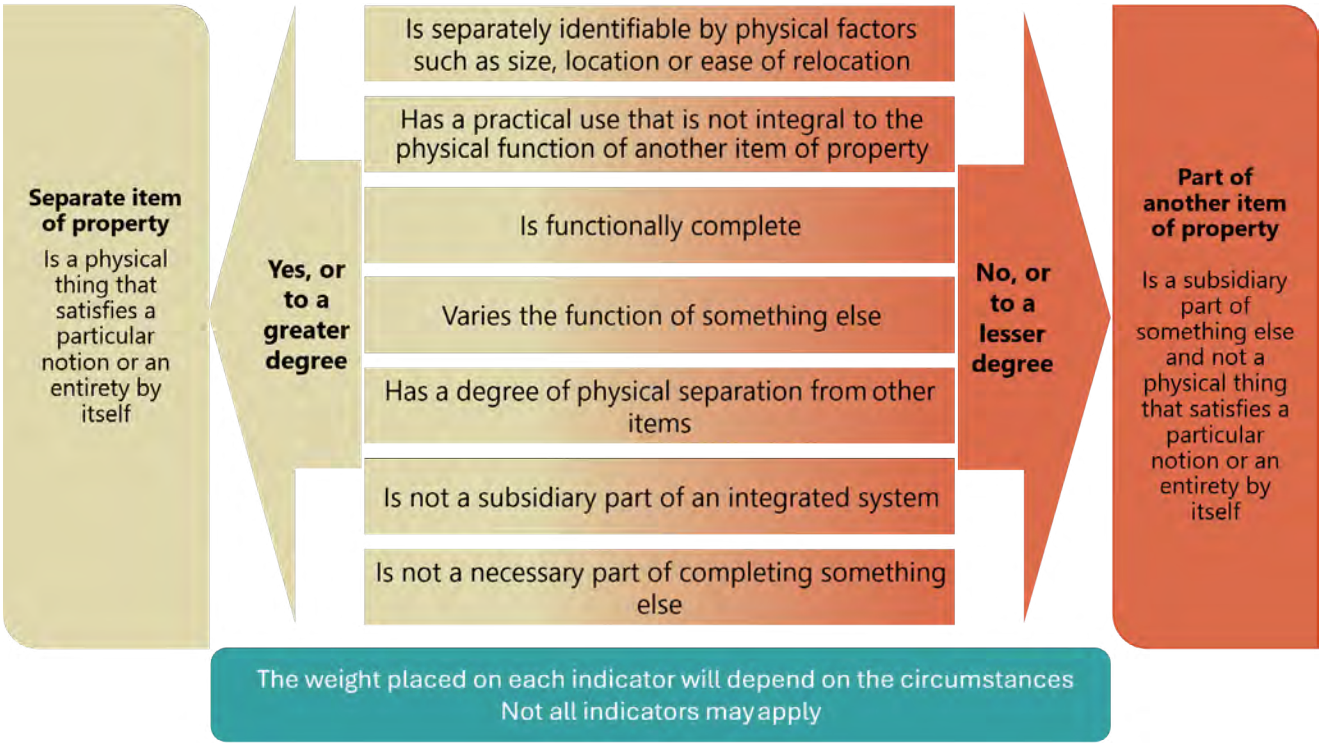
Summary | Whakarāpopoto

1. This statement considers how to identify an item of property to enable taxpayers to correctly determine the availability and amount of any depreciation loss deductions they may be entitled to claim.
2. The courts have approached this exercise on the basis that the answer is always a question of fact and involves matters of degree and impression. The listing of an item in a table of depreciation rates set by the Commissioner is not by itself determinative of the depreciation treatment of an item. This is because what is the relevant item of property is based on the use of the item in a particular taxpayer's circumstances. This means the same item of property may be treated differently by different taxpayers.
3. The focus is on identifying a physical thing that satisfies a particular notion. That is, something that is an entirety by itself and not a subsidiary part of anything else.
4. The focus is not on the item's operational or economic significance or on finding a profit-earning entity or on abstract concepts separate from the item's physical components.
5. Indicators that the item under consideration **is** an item of property include the following:
   - *The item is physically distinct from a wider asset of which the item might be a part.* Consider whether the item can be separately identified by physical factors (eg, location or size). Determine the item's function (ie, the practical use to which it is put) and consider whether this function is integral to the physical functioning of a wider asset of which the item may be a part. Also relevant is the relative size of the item, whether it can be relocated and the degree of physical attachment between items (ie, whether they can be easily separated or whether this would result in significant damage to either item or both items).
   - *The item is (to some degree) functionally complete.* Functional completeness is about whether the item can function on its own. However, this does not necessarily mean the item needs to be self-contained or used separately.
   - *The item varies the function of another item.* Two items will tend to remain separate items where one item varies the function of another item, enabling it to perform a more specialised function.
6. Indicators the item under consideration **is not** an item of property include the following:
   - *The item has a physical connection with other items.* Where a degree of physical connection exists between the item under consideration and other items this may indicate the item is not a separate item of property. This may indicate the item is not physically distinct from a wider item.
   - *The item is part of an integrated system.* Where the item is part of an integrated system designed to function as a whole, the item may lack its own functional distinctiveness and not be a separate item of property.

- *The item is a necessary part to complete something else.* An item under consideration will tend not to be a separate item of property if it is a necessary part to complete some other item. This relates to the concept of "completeness" and whether the other item would be considered incomplete or unable to function without the item under consideration.

7. These indicators are often the inverse expression of another and can be reduced to the form in Figure | Hoahoa 1.

Figure | Hoahoa 1: Determining whether something is an item of property



Introduction | Whakataki

Scope

8. This interpretation statement provides general guidance for identifying the relevant item of **tangible** property when applying the depreciation rules of the Act.[1]

9. The statement does not address how to distinguish expenditure that is capital in nature from that which is revenue in nature. It is assumed that a taxpayer has incurred capital expenditure and is concerned with identifying what the expenditure was for when applying the depreciation rules.

10. In addition to correctly identifying the relevant item of tangible property, other requirements must be met under the Act before a deduction for a depreciation loss will arise. Broadly, these additional requirements are that the:
    - taxpayer owns the item of property;[2]
    - property is depreciable property as defined;[3]
    - property is used, or is available for use, to derive assessable income;[4] and
    - depreciation loss is calculated in the correct manner (ie, using the correct method and rate).[5]

    These additional requirements are not discussed in this statement.[6]

1 This statement does not apply to **intangible** property.
2 Sections EE 1(2)(a) and EE 2 to EE 5.
3 Sections EE 1(2)(b) and EE 6 to EE 8.
4 Section EE 1(2)(c).
5 Sections EE 1(2)(d) and EE 9 to EE 11.
6 For more information on the application of the depreciation rules, see Inland Revenue: Te hekenga wāriu - Depreciation (webpage, Inland Revenue, last updated 18 September 2024).

11. The statement does not consider any rules that may apply to some items of property that may then affect whether they are treated as part of another item or are able to be depreciated separately. For example, whether an item is part of a commercial fit-out of a building or is part of a network for the distribution or conveying of electricity, gas, water or telecommunications.[7]

Relationship to other published guidance

12. This statement considers the issue of identifying an item of property in general terms. The Commissioner has published specific guidance that should be consulted instead of this statement where identifying the relevant item of property is needed to determine:
    - the deductibility of:
        - certain expenditure related to dairy farming (**IS0025**);[8]
        - expenditure on residential rental properties to meet the healthy homes standards (**QB 20/01**);[9]
    - whether the relevant item is a separate item of property or part of a residential rental building (**IS 10/01**);[10] or
    - what is a "building" for depreciation purposes (**IS 22/04**).[11]
13. There is also guidance on what to do if the relevant item of property has been incorrectly identified and an incorrect depreciation rate has been applied as a result.[12]
14. As discussed from [28], an item of property is a "physical thing which satisfies a particular notion" or an "entirety". In some cases, the specific guidance listed above has identified the particular notion or entirety that is relevant in the context of that guidance. For example, IS0025 refers to the "extraction of milk" as the particular notion in relation to milking plant. IS 10/01 and QB 20/01 apply where the relevant entirety may be a residential rental property. IS 22/04 applies where the relevant entirety may be a building.
15. Also, in the context of residential rental properties, the specific guidance in IS 10/01 includes a practical test that, although not drawn from (or found in) any specific case, is consistent with the case law and is a useful tool to apply in that context. QB 20/01 also applies the test in the context of residential rental properties.
16. In summary, this statement supplements, but does not replace, the earlier specific guidance. Therefore, the specific guidance should be consulted where it is relevant to the particular notion or entirety involved.
17. Also, the principles that apply to identifying the relevant item of property in the specific guidance and in the general context dealt with in this statement are the same, including where the issue concerns the deductibility of repairs and maintenance expenditure.[13]

7 See "commercial fit-out", "utilities distribution asset", "utilities distribution network" and "utilities distribution network operator" as defined in s YA 1.

8 IS0025: Dairy farming – deductibility of certain expenditure *Tax Information Bulletin* Vol 12, No 2 (February 2000): 10.

9 QB 20/01: Can owners of existing residential rental properties claim deductions for costs incurred to meet Healthy Homes standards? *Tax Information Bulletin* Vol 32, No 7 (August 2020): 126.
Healthy homes standards provide specific and minimum standards for heating, insulation, ventilation, moisture ingress and drainage, and draught stopping in rental properties: Healthy Homes (webpage, Tenancy Services, 2024).

10 IS 10/01: Residential rental properties – depreciation of items of depreciable property *Tax Information Bulletin* Vol 22, No 4 (May 2010): 16.

11 IS 22/04: Claiming depreciation on buildings *Tax Information Bulletin* Vol 34, No 8 (September 2022): 9.

12 QB 15/03: Income tax – changing to a different depreciation rate for an item of depreciable property *Tax Information Bulletin* Vol 27, No 4 (May 2015): 30.

13 IS 12/03: Income tax – deductibility of repairs and maintenance expenditure - general principles *Tax Information Bulletin* Vol 24, No 7 (August 2012): 68 at [99].

Analysis | Tātari

"Item of property"

18. The Act contains rules that permit depreciation loss deductions for assets used or available for use in deriving assessable income or in carrying on a business for the purpose of deriving assessable income.[14] The permitted deductions are based on a proportion of the cost of the asset. The proportion or depreciation rate is fixed by the Commissioner for assets of that type and is based on the asset's estimated useful life. If there is no appropriate depreciation rate, taxpayers can apply for a provisional rate.[15]
19. The term used in the depreciation rules for an asset is an "item of property".[16] Accordingly, when applying the depreciation rules, it is necessary to determine the relevant item of property to determine the appropriate depreciation rate to apply.
20. The identity of the item of property will determine its cost and whether that cost is below certain thresholds. These thresholds determine such things as:
    - Whether the cost of the item is such that it qualifies as an item of low value under s EE 38. Subject to certain qualifications, s EE 38 provides a 100% depreciation rate to items of depreciable property costing no more than a certain amount.[17]
    - Whether the item can be depreciated using the pool method of depreciation.
21. Another income tax matter that depends on the correct identification of the item of property includes whether the expenditure is for a separate item of property or is an improvement of an existing item of depreciable property. While under s EE 37 improvements can be depreciated at a taxpayer's option as if it were a separate item of depreciable property, the applicable depreciation rate is based on the item of depreciable property that is improved.[18]

Identifying the relevant item of property

22. The identity of the relevant item of property may be obvious in many cases but not in others. For example, it may not be obvious where:
    - two or more items are acquired or produced together, and the question arises as to whether they are separate items or have combined into a larger item of property;
    - an item acquired or produced relates to an existing item of depreciable property, and the question arises as to whether the item is part of the existing item; or
    - an existing item has been, arguably, incorrectly identified.
23. In the third case listed, this may be where something has been incorrectly treated as forming part of a larger item of property when it is a separate item of property or where the opposite has occurred.
24. The fact that an item has a depreciation rate determined by the Commissioner does not mean such an item is always treated as a separate item of property.[19] Nor is how a person has treated an item for accounting purposes or in a tax fixed asset register necessarily determinative.[20] The item of property must be identified first consistent with the guidance set out in this statement and the other published guidance mentioned in [12]. Then, the depreciation rate is determined by finding in the Commissioner's depreciation determinations the item description that most accurately describes the asset, as identified.[21]

14 Subpart EE.

15 See Depreciation – a guide for business – IR260 (guide, Inland Revenue, April 2023) at p33 – 34.

16 Section EE 1(2). The term "item of property" is not defined in the Act.

17 Currently, $1,000.

18 See IS 10/01 at [8].

19 See QB 20/01 at [30] and IS 10/01 at [62]

20 Although, a company is required to maintain a detailed taxation-based register (see Clause 1(b) of the schedule to the Tax Administration (Financial Statements) Order 2014).

21 See QB 15/03 from [13].

25. The object of the exercise considered in this statement is to identify the relevant item of property. It is the same exercise as is conducted in the context of repairs or maintenance where the object is to identify the subject matter of the work completed to determine whether the expenditure incurred carrying out that work is deductible or capitalised to the cost base of the relevant asset.[22]

26. **The courts have approached this exercise on the basis that the answer is always a question of fact and involves matters of degree and impression.** For example, in *Auckland Trotting Club*,[23] the Court of Appeal agreed with the views expressed in *Phillips v Whieldon Sanitary Potteries*[24] that "there is no one line of approach to the problem that is exclusively correct" and in *Margrett*[25] that the decision is "essentially a question of fact and of degree".[26] In *Hawkes Bay Power*, the High Court stated that the question of what is the entirety was "a matter of degree and of the right conclusion to be drawn from the facts".[27] And, in *Case N8*, the Taxation Review Authority stated "[i]t is a question of fact, degree and impression as to what is included or excluded in an entity".[28]

27. Despite this, factors derived from the case law can help indicate whether the item under consideration is or is not an item of property.

28. First, the courts have said the focus of the exercise is on identifying:
    - a "physical thing which satisfies a particular notion";[29]
    - something that is an "entirety by itself" and "not … a subsidiary part of anything else";[30] and
    - "the totality or entirety of the physical asset".[31]

29. Court decisions also show that the focus is **not** on:
    - the operational significance or economic value of the item (including the need for the thing to be used in conjunction with other things or systems to realise that value);[32]
    - a profit-earning structure or entity;[33] or
    - abstract concepts separate from the physical components of the item.[34]

30. As discussed next, the decisions show there are various indicators that suggest whether the item under consideration is or is not the relevant item of property. Due to the courts sometimes expressing the same or similar concept in different terms, some of the indicators are a subset or an inverse of another and there is a degree of overlap between them. **The weight to be given to each indicator and whether any one indicator is determinative depends on the circumstances.**

31. Some indicators help determine if the item under consideration **is the relevant item of property.** These indicators include where the item is:
    - physically and functionally distinct from a wider asset that the item might be part of;
    - functionally complete (to some degree); or
    - varying the function of something else.

22 This is because the tests are derived from the same case law. This comes about because, historically, the rules for depreciating business assets and for claiming deductions for the cost of repairing and maintaining those same assets, were linked in the income tax legislation (s 108 of the Income Tax Act 1976 and see IS 10/01 at [45]).

23 *Auckland Trotting Club v CIR* [1968] NZLR 967 (CA).

24 *Phillips v Whieldon Sanitary Potteries Ltd* (1952) TC 213 per Donovan J at 219.

25 *Margrett v The Lowestoft Water & Gas Co* (1935) 19 TC 481 per Finlay J at 488.

26 *Auckland Trotting Club* at 975 and 976.

27 *Hawkes Bay Power Distribution Ltd v CIR* (1998) 18 NZTC 13,685 (HC) at 13,701.

28 *Case N8* (1991) 13 NZTC 3,052 (TRA) at 3,070.

29 *Lindsay v FCT* (1961) 106 CLR 377 (FCHCA) at 384 adopted in *Auckland Trotting Club* (CA) at 975. See also *Hawkes Bay Power* (HC) at 13,701, *Poverty Bay Electric Power Board v CIR* (1999) 19 NZTC 15,001 (CA) at 15,007 and *CIR v Auckland Gas* (1999) 19 NZTC 15,011 (CA) at 15,019.

30 *Lindsay v FCT* at 385. See also *Hawkes Bay Power* at 13,701.

31 *Auckland Gas* (CA) at 15,019 and *Poverty Bay Electric Power Board* at 15,006.

32 *Auckland Gas* (CA) at 15,026.

33 *Auckland* Gas (CA) at 15,019.

34 *Auckland Gas Co Ltd v CIR* (2000) 19 NZTC 15,702 (PC) at 15,707 see IS 12/03 at [58].

32. Some indicators suggest the item under consideration **is not the relevant item of property.** These indicators include where the item:
    - has a degree of physical connection with other items;
    - is part of an integrated system; or
    - is a necessary part of completing something else.

Indicators the item is an item of property

Physical and functional distinctness

33. The focus is to identify a "physical thing which satisfies a particular notion" or "an entirety". It follows that a physical thing or entirety should, in some way or ways, be distinct from other things. The court decisions show that physical and functional distinctness is a primary concern in such considerations. Distinctness is discussed in IS 12/03:

> 11. When considering whether something is a distinct asset it may be helpful to determine whether the thing can be separately identified by physical factors, for example, its location or size (*Lindsay* v *FCT* (1961) 106 CLR 392 (Full Ct HCA), *Hawkes Bay Power Distribution Ltd* v *CIR* (1998) 18 NZTC 13,685 (HC), *O'Grady (HM Inspector of Taxes)* v *Bullcroft Main Collieries Ltd* (1932) 17 TC 93 (KB), *Samuel Jones & Co (Devondale) Ltd* v *CIR* (1951) 32 TC 513 (IH (1 Div)), *Margrett (HM Inspector of Taxes)* v *Lowestoft Water and Gas Co* (1935) 19 TC 481 (KB)). Something that is physically divisible and distinct from other things might suggest that it is a single asset (*Case F67* (1983) 6 NZTC 59,897, *O'Grady*, *Samuel Jones*, *Margrett*). Also, a physical connection between component parts will often be relevant to finding a single asset (*Auckland Gas* (CA)). Subsidiary parts of an integrated system should be considered part of that system rather than assets in their own right (*Poverty Bay Electric*, *Hawkes Bay Power*).
>
> 12. Similarly, **determining something's function may also be helpful** when identifying the relevant asset being worked on (*Auckland Gas* (CA), *Poverty Bay Electric*, *Hawkes Bay Power*, *Case N8* (1991) 13 NZTC 3,052). **A smaller thing that is integral to a larger asset's ability to physically function is not likely to be the relevant asset** (*Hawkes Bay Power*), while something that is physically capable of separate operation by itself is more likely to be the relevant asset in a repairs and maintenance context (*Poverty Bay Electric*, *Hawkes Bay Power*). [Emphasis added]

34. Other physical aspects mentioned in IS0025 include considering the relative size of the item and whether it can be relocated. IS 10/01 considers items that can be relocated within a residential rental building are more likely to be considered separate items of property.[35] IS 10/01 considers it is relevant to consider the degree of physical attachment between items such as whether an item is built-in or attached or connected to a building in such a way the item's removal would be difficult or result in significant damage to the item, the building or both.[36]
35. QB 20/01 considered determining whether a smaller thing is integral to a larger asset included any legal requirements with a bearing on the larger thing's functionality. The need for a property to include certain things to meet regulations concerning healthy homes so the property fulfilled the notion of a "residential rental property", was considered relevant.[37]
36. For depreciation purposes, buildings are treated differently from other items of property (eg, claiming a loss on disposal is limited).[38] IS 22/04 considers the appearance and function of a structure are relevant to determining whether the structure is a building for depreciation purposes.[39]
37. In *Case F67*, in the context of identifying the item of property for repairs and maintenance purposes, Barber DJ considered that a rental property divided into two shops was a single item of property despite this division because the property functioned as one set of premises in terms of title, ownership, insurance and administration of the tenancies.[40]

35 See IS 10/01 at [68], [202] and [215].

36 See step 3 of the three-step test set out in IS 10/01.

37 See QB 20/01 at [11] – [13].

38 Note that from 1 April 2024 a 0% depreciation rate applies to all buildings (see: *Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters)* Act 2024).

39 See IS 22/04 at [33].

40 *Case F67* (1983) 6 NZTC 59,897 (TRA).

38. The Court of Appeal in *Queenstown Airport Corporation Ltd* considered whether runway end safety areas at the Queenstown airport were depreciable property.[41] This decision supports the view that an item of property for depreciation purposes is something with a separate function and is physically distinct. To be depreciable, the runway end safety areas had to fall within one of the categories of depreciable land improvement listed in schedule 13 of the Act. The taxpayer argued, among other things, that the runway end safety areas formed part of the wider runway system and fell within the term "airport runway" listed in schedule 13. The court decided that it did not, because the runway end safety areas were functionally and physically distinct from the airport runway. The court said:

> [68] **We do not accept the appellant's argument that the RESAs [runway end safety areas] are airport runways because they form part of the wider runway system.** Mr Goddard submitted the airport could not lawfully be operated for international flights without the RESAs. He argued accordingly that they were an integral part of the overall runway system. For the Commissioner, Mrs Courtney accepted that RESAs could be regarded as part of the wider runway system but we accept her submission that **the RESAs are functionally and physically distinct from the airport runway** for the reasons we have already set out. [Emphasis added]

39. The reasons the court had earlier set out for runway end safety areas being functionally and physically distinct were that:

- the runway had a bituminous surface on which aircraft took off and landed, whereas the runway end safety areas were grassed and not used by aircraft except in an emergency;[42] and
- obvious distinctions existed between the runway and runway end safety areas in their usage and maintenance requirements, including that the runway:
  - had annual usage of about 8,000 take-offs and landings, whereas the runway end safety areas had not been used; and
  - was subject to significant loads and had a design life of 5 to 10 years, whereas the runway end safety areas required minimal maintenance and had a design life of 120 years.[43]

40. In an Australian context concerned with a "unit of eligible property", function was found to be a useful guide. For instance, in *Tully* (FCA), Lockhart J said:[44]

> Helpful though the dictionaries are they do not provide much practical guidance in determining the meaning of the expression "unit of eligible property" for present purposes. It is true that ultimately the question what constitutes "a unit of eligible property" depends on the facts of the particular case, but some guidance to the Commissioner and taxpayers is called for. In my view, the nearest one can get to enunciating a test of fairly general application is that **it is the function or purpose of the particular item to which one looks to see if it answers the description on the facts of the case of "a unit of eligible property"**. …
>
> The difficulty of identifying a "unit of property" for the purposes of the Assessment Act is that sometimes an item may be correctly described as a "unit" when it is one of a number of parts which upon assembly perform a subsidiary function. **Sometimes each part may be correctly described as a unit before assembly and at other times after assembly. On other occasions there may not be a unit until a number of parts have been integrated into a complete system.** Then the whole may answer the description of a unit. The possibilities and combinations are numerous. **But purpose or function must generally be a useful guide to the identification of an item as answering the description of a unit of property in particular cases**. [Emphasis added]

41. In *Monier Colourtile* (NSWSC), one issue was whether a two-way radio "system" comprising a base station, mobile receiver transmitters and an executive handset was a "unit of eligible property".[45] The taxpayer argued that the components of the two–way radio system were one unit of property because the components were useless without each other. Lee J said that, while that was true in a commercial sense so far as the user was concerned, the test has regard to the unit and its purpose or function. He concluded that the base station and the mobile stations each had a distinct function and were separate units of property:[46]

41 *Queenstown Airport Corporation Ltd v CIR* [2017] NZCA 20.

42 At [50].

43 At [57]–[59].

44 *FCT v Tully Co-operative Sugar Milling Association Ltd* 83 ATC 4,495 (FCA) at 4,504.

45 *Monier Colourtile Pty Ltd v FCT* 83 ATC 4,399 (NSWSC).

46 At 4,406–4,407.

> The contention advanced on behalf of the company is that all the components of the system constitute one unit of property — or at the very least those in the initial acquisition in February, viz. the base station and the fourteen mobiles. **It is stressed that the base station is useless without one or more mobile stations and vice versa. Whilst it must be acknowledged that this is true in a commercial sense so far as the user is concerned, that forms no basis for a conclusion that the entirety is to be regarded as one unit** for the purposes of sec. 82AB. The test laid down in Tully Co-operative Sugar Milling Association Ltd. v. F.C. of T. … results in the conclusion that **the base station, each mobile station and the handset were separate units of property, within the meaning of the section**. …
>
> … **The test has regard to the unit and its purpose or function,** without regard to the fact that that function may only become commercially useful or valuable to the holder of the property if some other equipment is also put to use according to its particular function. [Emphasis added]

42. On appeal, the Full Court of the Federal Court of Australia found no reason to disturb Lee J's finding.[47]
43. And, in *Veterinary Medical*, Pincus J said the function identified must be the "external function", which he described as the practical use to which the unit is able to be put in the taxpayer's business:[48]

> **The test of function is of no use unless one decides what sort of function is relevant.** …, it appears to me that if the function test is to have any sensible use, the function identified must be, so to speak, the external function — **the practical use to which the unit is able to be put in the taxpayer's business.** [Emphasis added]

44. Accordingly, two approaches to considering physical and functional distinctness may be to consider whether something:
    - is seperately identifiable by physical factors such as size, location or ease of relocation; or
    - has a practical use that is not integral to the physical function of another item of property.

Functionally complete (to some degree)

45. Functional completeness is about an item's function and its ability to carry out that function. Functional completeness does not mean the item performs a different function to another item. It is about whether the item can function on its own or is integral to the functioning of a wider asset.
46. IS 10/01, after considering the issue of "completeness" and the decision in *Poverty Bay Electric Power*, concludes:

> 124. In addition, the court [in *Poverty Bay Electric Power* (CA)] found that a smaller part of the network was not the relevant asset because it was only part of an integrated system incapable of separate operation. This strongly suggests it is relevant that an asset be able to function by itself (ie, it includes all the parts that are necessary for it to function) and, similarly, that subsidiary parts of an "integrated system" should be considered part of that system rather than assets in their own right.

47. And, after then considering *Auckland Gas* (CA), IS 10/01 concludes:

> 129. It can be seen from this[49] that Blanchard J focuses on the fact that one item (the low pressure system) is dependent on another for its function — that is, it is unable to function separately. This is a "completeness" test — that is, the relevant item includes all the physical things necessary for it to carry out its function and would be incomplete if one of the items necessary for it to function was not included.

48. Functional completeness is also mentioned in IS 12/03 at [65] where it refers to "a functional unit in its own right" and in IS0025 under the heading "Summary of the key principles taken from these cases".
49. However, functional completeness, as described in the earlier guidance set out above, does not necessarily mean the relevant item is self-contained or separately used (eg, it may require power from an external source or be a machine in a manufacturing process). This follows from Australian decisions on a "unit of eligible property". Fitzgerald J in *Tully* (FCA) referred to an item that requires power from an external source or a machine that is incorporated into a manufacturing process but capable of separate function. Fitzgerald J said:[50]

> I see no reason to doubt that there is, for present purposes, a unit of property if it is capable of independent existence, **not necessarily self-contained,** e.g. **it may require power from an external source, not necessarily separately used, e.g. it may be incorporated into an operating system such as a machine or complex of machinery in a manufacturing process, but capable either of separate function, or of function in conjunction with different parts, or in a different context, from its current user**. [Emphasis added]

47 *Monier Colourtile Pty Ltd v FCT* 84 ATC 4,846 (FCFCA) at 4,850.

48 *FCT v Veterinary Medical and Surgical Supplies Ltd* 88 ATC 4,642 (FCA) at 4,648.

49 *Auckland Gas* (CA) per Blanchard J at 15,019 cited in IS 10/01 at [128].

50 At 4,506.

50. In *Monier Colourtile* (NSWSC), Lee J said the test had regard to the unit and its purpose or function without regard to the fact it may become commercially useful or valuable only if some other equipment were also put to use according to its particular function. By way of example, Lee J referred to a television set and transmitter:[51]

> **The test has regard to the unit and its purpose or function, without regard to the fact that that function may only become commercially useful or valuable to the holder of the property if some other equipment is also put to use according to its particular function.** Such a state of affairs has always been commonplace, and modern technology increases the instances of interaction of the functions of diverse pieces of property. **A television set is still a television set although the television station goes off the air. A transmitter remains a transmitter though there be no receiver.** Each can be separately replaced as required and separately paid for. Each can be separately located, remote from each other. [Emphasis added]

Varying the function of something else

51. An item of property that varies the function of another item of property (eg, it enables the other item to be used for a specialised purpose) will tend to remain a separate item of property. Generally, the two things will not combine to form a larger whole.

52. In *Tully* (QSC), Thomas J referred to a separate unit of eligible property could arise where the item varied the performance of something else:[52]

> In my opinion a component may be a unit of property for the purposes of sec. 82AB in the context of a manufacturing system, if it can be shown to perform a discrete function, or if it can be shown to vary the performance of that system.

53. And in *Monier Colourtile* (NSWSC), Lee J stated:[53]

> A "unit" is, as a matter of ordinary English, an entity, an entire thing in itself, and whether property is such can for the purposes of the Act be ascertained by reference to its capacity to perform a definable, identifiable function. The function test, furthermore, readily accommodates the case where any number of single items, each having a specific purpose, are brought together so as to create an item having its own function. A motor car for instance comprises multifarious parts, each having a specific function, but all in combination produce a readily identifiable unit with its own individual function, viz. a means of carriage of persons, a vehicle. **Such a case is of course always to be distinguished from the mere attachment together of items of property which themselves have a separate independent function**. No new unit of property is then created. …
>
> The test set out in Tully, however, also covers the case where some piece of property on being "attached" to a unit of property which has its own independent function varies the performance of that unit. In that event, the attachment and the original unit do not constitute a further unit of property but each remain as separate units of property. An illustration of this is to be found in Wangaratta Woollen Mills Ltd. v. F.C. of T. …. McTiernan J. at ATC p. 4103; C.L.R. p. 13 said:
>
> > "Counsel for the Commissioner submitted that a sliver can with piston and spring is a 'unit of property' to which the words 'manufacturing plant' in subsec. (1) apply. He said that a piston and spring without the can were in the nature of spare parts for the 'unit of property', and that it was the policy of the section to encourage manufacturers to buy new plant, rather than to patch up the old. In my opinion it is not necessary to embark upon this consideration of policy. Sliver cans are used in the spinning factory for other purposes besides use with spring and piston to hold a sliver. For example they are commonly used to hold fibre bobbins on removal from the machine. **I therefore regard the can as one unit of property, and the spring and piston as another, as an additional attachment to enable the can to be used for a more specialised purpose. It is true that the spring and piston cannot be used without the can, but the same could be said of any attachment for a tractor such as a mower or post hole digger operated from a power take off.**" [Emphasis added]

54. Lee J also referred to the Australian Board of Review *Case M98* where a tractor was held to be a separate unit of property from two items of equipment used with it (a carry-all and soil ripper).[54] The tractor was held to have its own independent function – as a tractor. The items of equipment had purposes even though they needed the tractor to pull them. Lee J explained that the items of equipment enabled the tractor to be used for a specialised purpose:[55]

51 At 4,407.

52 *Tully Co-operative Sugar Milling Association Limited v FCT* 82 ATC 4,454 (QSC) at 4,459.

53 At 4,405.

54 *Case M98* 80 ATC 689.

55 At 4,405.

> A similar problem arose in Case M98, 80 ATC 689 dealt with by the Board of Review. There the taxpayer, a grazier, claimed an investment allowance with respect to a tractor and two items of equipment used with it, a carry-all which cost $252 and a soil ripper, which cost $164. The investment allowance was allowed in respect of the tractor but not in respect of the two items of equipment, each being less than $500. The Board treated all three items as separate units. The tractor had its own independent function, as a tractor, and the carry-all and the ripper, in order to carry out their purposes, needed the tractor to pull them. The carry-all and the ripper, it could be said, applying the approach made by McTiernan J. in Wangaratta Woollen Mills Ltd. v. F.C. of T. … enabled the tractor to be used for specialised purposes.

Indicators the item is not an item of property

Degree of physical connection or separateness

55. The indicators discussed in this statement can sometimes be seen as the inverse expression of other indicators. For instance, where a degree of physical connection exists with other items, there is, arguably, a lack of physical distinctness or separateness. On the other hand, a degree of physical connection between things does not necessarily make them a single item for depreciation purposes (such as, where the item varies the function of another item, as discussed from [51]). Also, a lack of physical connection does not necessarily make different items separate items of property (such as, where they are part of an integrated system, as discussed from [60]).

56. However, two Australian decisions, *Veterinary Medical* and *Monier Colourtile* (NSWSC), both concerning a "unit of eligible property", provide an interesting contrast between situations where the absence or presence of physical connection may have been determinative. *Veterinary Medical* concerned whether a telephone system consisting of a central processing unit and seven physically connected handsets was considered a single unit. Pincus J said that Lee J's decision in *Monier Colourtile* (NSWSC) (where each component of the two-way radio "system" was considered a separate unit) would suggest the telephone system under consideration in the case should also comprise multiple units of property.

57. However, despite this, Pincus J went on to find that the elements of the telephone system constituted one unit of property. Pincus J accepted the earlier finding in the tribunal that "no part of the system could operate without the integrity of the physical connection between the main equipment and the stations being preserved".[56]

58. The fact the elements of the telephone system were physically connected appears to have been a factor in Pincus J's decision. Pincus J said:[57]

> The result of the radio system aspect of the Monier Colourtile case is at first sight consistent with the view that such a collection of items as is here in question constitutes as many units as there are items.
>
> However, in Tully Co-operative Sugar Milling Association Limited v. F.C. of T. 82 ATC 4454 a conclusion was come to which some may find hard to reconcile with that in the later case. There the "mixed juice pumping station" dealt with by Thomas J. at p. 4457 et seq. consisted of a number of items, …
>
> …
>
> **The degree and permanence of physical connection differ in the cases I have mentioned**: presumably it would be easier to disconnect the handsets in issue in this case than to take out the motors in the Tully case; **in *Monier Colourtile*, the various elements were not physically connected at all.** That factor appears, in the passages I have quoted above, to have weighed heavily with Lee J., but not necessarily with the Full Court. …
>
> … I doubt if one can satisfactorily explain the difference between the outcome of the Tully case, in so far as it related to the mixed juice pumping station, and the outcome of the Monier Colourtile case in so far as it related to the radio communication system, other than by reference to the lack of physical connection in the latter case. …
>
> … it appears to me that where a system consisting of diverse elements is bought as a system intended to function as a whole and each element interacts with at least one other, one should find unity in the function of the whole system, **at least where the elements are physically connected**. [Emphasis added]

59. The degree of physical connection between items is also discussed in IS 10/01[58] and in IS 12/03.[59]

56 *Case U132* 87 ATC 771 at 773.

57 At 4,648.

58 At [131] and [134] and step 3 of the three-step test set out in that statement.

59 At [59] and [85] – [86] (in relation to *Case N8* where items were separate items when the only physical connection between them was electrical wiring) and in the summary at [97].

Is part of an integrated system

60. A thing that combines sufficiently with other things to create a larger whole with a unified function will generally be regarded as not being functionally complete nor physically and functionally distinct and the item of property will be the larger whole.

61. As mentioned in IS 12/03 (see [33]), "subsidiary parts of an integrated system should be considered part of that system rather than assets in their own right". IS 10/01 also refers to this indicator.[60] The view is supported by the decisions in *Poverty Bay Electric Power Board*, *Hawkes Bay Power* and *Auckland Gas* (CA).

62. In *Veterinary Medical*, Pincus J concluded that, in addition to being physically connected, the elements of the telephone system constituted one unit of property because they were part of a system intended to function as a whole:[61]

> It is preferable to apply the function test here by denying that an individual handset has a separate function for present purposes, and affirming that each element should be treated as part of a system intended to function as a whole. A handset can do nothing by itself.
>
> Entirely separate questions arise where (as in the first branch of the Monier Colourtile case) one is dealing with elements which are not permanent parts of the system, or dealing with later additions to an initial installation. Leaving those special cases aside, **it appears to me that where a system consisting of diverse elements is bought as a system intended to function as a whole and each element interacts with at least one other, one should find unity in the function of the whole system, at least where the elements are physically connected.** [Emphasis added]

63. In *Tully* (FCA) Lockhart J said there may not be a unit until a number of parts have been integrated into a complete system (see [40]).

64. In *Monier Colourtile* (NSWSC), Lee J said that the "function test" readily accommodated a case where several single items, each having a specific purpose, were brought together to create an item having its own function. By way of example, Lee J referred to the parts of a motor car, each having a specific function, but all in combination producing a readily identifiable unit with its own individual function (see [53]).

65. The fact elements of a system are interchangeable or can be used elsewhere does not stop the entire system being treated as an item of property. In *Veterinary Medical*, Pincus J said as long as the elements interacted with each other, it did not matter that they were interchangeable:[62]

> There was debate before me about the interchangeability of elements and the possibility of using some elements elsewhere than in the system in question. Handsets could be taken away, or additional handsets could be incorporated into the system. …
>
> It does not appear to me, however, that it is consistent with the result arrived at in the Tully case to hold that the existence of these possibilities precludes the whole system's being treated as one unit. As long as the elements interact with one another, I do not think it matters whether their interaction is immutable; …

66. A feature of an integrated system is that components of the system have been brought together to interact with each other. However, separate items of property frequently interact without that interaction necessarily creating an integrated system (see example 1). The interaction of the component items of an integrated system must be such that each component's individual function has been absorbed into a unified function of the system so that the component is not physically and functionally distinct nor functionally complete.

67. Therefore, relevant considerations will be of matters that go to the strength of the interaction between the components, such as the frequency and duration of their interaction. This intended interaction may be more evident where the components are physically connected or physically interact and form permanent parts of the system.

68. It may also be relevant to the question of any intended interaction and unified function if, for instance, the item was one of many items acquired at the same time from the same supplier as part of a "package" of items commonly sold together with a unified function.

69. However, the indicator that the item is part of an integrated system may be stronger and carry more weight in some situations than in others. For instance, the New Zealand cases mentioned above involved systems that were relatively large with specialised unified functions comprised of numerous components. The Australian cases referred to above, however, involved systems less complex ranging from systems within manufacturing processes to telephone systems.

60 See also at [122] – [124], [140] – [141] and [151].

61 At 4,648.

62 At 4,648.

70. In terms of some of the indicators discussed above from [31], where an integrated system arises the component items become necessary parts of completing the system and are not functionally complete. However, as with the application of any of the indicators, whether an integrated system exists and the extent to which various items are included in it, is a question of fact and degree to be determined on a case-by-case basis. Any single item of property may be made up of interdependent parts, but there is "a danger of distortion if too large or too small a subject matter is identified" as the relevant item of property.[63]

71. The identification of a unified function for the integrated system into which the individual functions of its components have been absorbed, is a key consideration. The unified function will not only indicate the existence of an integrated system but also the treatment of any other items that may subsequently interact with the system. Another item may subsequently become an additional component of the system if it improves the established unified functionality.[64] In contrast, another item may simply vary the system's established unified function without becoming part of the system, (see example 3).

Is a necessary part of completing some other item

72. Incompleteness or its converse, completeness, covers a variety of differently expressed factors that cross-over with other indicators discussed above. In IS 10/01 they are discussed as follows:

> 140. Completeness involves a consideration of whether the item is:
>
> - an integral part of the asset (*Auckland Trotting*, *Hawkes Bay Power*);
> - a subsidiary part of something else or can be independently installed without recourse to other items (*Lindsay*, *Hawkes Bay Power*);
> - necessary for the asset to function (*Lindsay*, *Hawkes Bay Power*, *Auckland Gas* (CA));
> - capable of separate operation or whether it is part of an integrated system (*Poverty Bay*, *Auckland Gas* (CA));
> - clearly distinguishable (*Poverty Bay*).
>
> 141. It is considered that all of these factors are directed to a similar enquiry. For example, whether an item is an integral part of an asset, is the same question as whether the item is necessary for the asset to function. Whether the item is a subsidiary part of something else is asking the question another way — that is, if it is a whole standalone asset that can function by itself, it is less likely to be a subsidiary part of something else. However, where an item is an integral part of the asset in question, then it will be a subsidiary part of that asset. Similarly, whether the item is capable of separate operation or whether it is part of an integrated system is making the same enquiry.
>
> 142. **Consequently, it is considered that all of the above factors can be combined into one enquiry along the lines of: is the item in question part of a larger asset that would be considered incomplete or unable to function without the item in question?** In this regard, if the item is complete and capable of separate operation on its own this will point towards the smaller item not being a necessary part of a larger item. [Emphasis added]

73. In *Tully*, completeness was referred in the following terms:[65]

> It is not necessary that [a unit of eligible property is] functionally operative though in many circumstances this may be called for. For example, if five parts are installed in an assembly line and all that is needed to render the line operative is a sixth part, but until that part is installed no part may function or operate, the **functional incompleteness does not necessarily deprive each of the five units of its character as "a unit of eligible property" for the purposes of the Assessment Act. It depends on the facts of the case. Yet, at other times a "unit" may not come into being until all the components have been assembled.** For example, a farm fence is made up of a number of posts and rails or wires. It is difficult to conceive of any "unit" coming into being until the fence is erected. [Emphasis added]

63 *Poverty Bay Electric Power Board* at 15,006.

64 In which case it cannot be treated as an item of low value under s EE 38 because the provision does not apply to items that become part of another item of property (s EE 38(1)(d)).

65 At 4,504.

74. In *Monier Colourtile,* the Full Federal Court of Australia cited the passage from *Tully* shown above, and concluded:[66]

> **The trial Judge found as a fact that each of the mobile stations was functionally complete in itself** and each had a separate independent existence. He noted that it was stressed by the taxpayer that the base station was useless without one or more mobile stations and vice versa. Whilst he acknowledged that this was true in a commercial sense as far as the user was concerned, he regarded this circumstance as no basis for a conclusion that the entirety was to be regarded as one unit for the purposes of sec. 82AB. In his view each was capable of independent operation although such operation was not the operation for which the taxpayer acquired the property.
>
> In our opinion there is no reason to disturb this finding of the trial Judge. [Emphasis added]

75. Functional completeness is also referred to in IS 22/04 in relation to the characteristics of a "building".[67]

Summary of the indicators

76. An indicator that the item under consideration **is** an item of property includes where the item is physically and functionally distinct from a wider asset of which the item might be a part. This requires considering whether the item can be separately identified by physical factors (eg, location or size). It also requires determining the item's function (ie, the practical use to which it is put) and considering whether this is integral to the physical functioning of a wider asset of which the item may be part.
77. Other indicators that the item under consideration **is** an item of property include whether the item is (to some degree) functionally complete or where the item varies the function of something else. Functional completeness is about whether the item can function on its own, although this does not necessarily mean the item needs to be self-contained or used separately.
78. Where the item under consideration varies the function of another item it will tend to remain a separate item and the two things are not considered to be combined to form a larger item of property. For example, two items will tend to remain separate items where one item varies the function of another item, enabling it to perform a more specialised function such as a mechanised rear blade attachment for a tractor.
79. Indicators suggesting the item under consideration **is not** an item of property are where the item has a physical connection with other items, is part of an integrated system or is a necessary part to complete something else.
80. Where a degree of physical connection exists between the item under consideration and other items, this may indicate the item is not a separate item of property. This may indicate the item is not physically distinct from a wider item.
81. However, a lack of physical connection does not necessarily mean the item is a separate item of property where the item is part of an integrated system designed to function as a whole. In that case, the item may lack functional distinctiveness.
82. An item under consideration will tend not to be a separate item of property if it is a necessary part to complete some other item. This relates to the concept of completeness and whether the other item would be considered incomplete or unable to function without the item under consideration.
83. Determining the item of property in each case requires considering all the circumstances and weighing up the various indicators. It is always a question of fact and degree.

66 At 4,849.

67 At [32].

Examples | Tauira

The following seven examples illustrate how the indicators discussed above help to identify the relevant item of property for depreciation purposes.

Example | Tauira 1: Utility vehicle and trailer

Tow and Mow Services Ltd recently acquired a second-hand utility vehicle and a trailer for its garden maintenance business. Tow and Mow acquired the vehicle and trailer from the same vendor at the same time. It wants to know whether the trailer is a separate item of property or part of the vehicle for depreciation purposes.

The vehicle and trailer are separate items of property for depreciation purposes for the following reasons:

- The trailer has a separate function from the vehicle. The function of the vehicle is primarily to transport people, whereas the trailer transports things.
- The trailer functions to transport things as a supplement to the vehicle where those things could not be suitably transported by the vehicle
  (eg, large items of equipment, large volumes of raw materials or garden waste). Accordingly, the trailer varies the function of the vehicle allowing it to perform a specialist purpose. This suggests they are separate items of property despite having at times, a degree of physical connection.
- The vehicle is functionally complete – it can function without the trailer
  (ie, the trailer is not required to complete the vehicle). While the trailer cannot transport things unless towed by a vehicle, the trailer is functionally complete in that it includes all that is necessary to fulfil the particular notion of a "trailer".
- Both the vehicle and the trailer are physically distinct and can be located separately.
- The vehicle and trailer are not parts of an integrated system (either together or together with other items) such as to suggest they are not separate items of property.
- While a limited degree of physical connection exists between the vehicle and the trailer, this arises only when the trailer is in use, and they are easily separated without damage to either.
- The degree and strength of the physical connection on its own is not sufficient to suggest an integrated system arises and the vehicle and the trailer each remain an entirety and a separate item of property.

Example | Tauira 2: Vehicle GPS unit

Jim Fargo owns a courier delivery business. He recently bought a larger vehicle to accommodate increased demand for his services. The vehicle did not come with a factory-fitted global positioning system (GPS), so Jim bought a portable GPS unit.

The GPS unit has the option of being plugged into the vehicle's power supply and can be easily mounted on the dashboard. Jim wants to know whether the GPS unit is a separate item of property or whether it is part of the vehicle.

The delivery vehicle and GPS unit are separate items of property for depreciation purposes for the following reasons:

- The GPS unit has a separate function from the delivery vehicle. The function of the delivery vehicle is to transport people and things whereas the GPS unit provides information to assist with navigation.
- The GPS varies the function of the vehicle. It enables the vehicle to be used more efficiently for a specialised purpose of delivering goods.
- The functional aspects of the items suggest they are separate items of property despite having a degree of physical connection.
- The delivery vehicle is functionally complete – it can function without the GPS unit (ie, the GPS unit is not required to complete the delivery vehicle).
- Although the GPS unit is unable to function without being wired into the vehicle's power supply, this alone does not deprive it of its status as a separate item of property for depreciation purposes. It is functionally complete in that it includes all that is necessary to fulfil the particular notion of a "GPS unit".
- The delivery vehicle and GPS unit are not parts of an integrated system (either together or together with other items) such as to suggest they are not separate items of property.

The delivery vehicle and GPS unit do have a reasonable degree of physical connection, which could suggest they should be treated as a single item. However, the manner of their physical connection is such that they can be physically separated at any time without damage to either item. This factor alone is not determinative, and all other factors must be considered as a whole.

On balance, the vehicle and the GPS unit can each be considered an entirety, and each is a separate item of property.

The conclusion in this example might be different if Jim purchased a GPS unit that needed to be installed into the vehicle for it to function. That is, the GPS unit needed to be hardwired into the vehicle's power supply and permanently affixed into the vehicle's dashboard.

Example | Tauira 3: Desktop computer package

DeskJobs Ltd buys a desktop computer consisting of an all-in-one computer (ie, monitor, processor and data-storage unit integrated in a single unit) plus a wireless keyboard and mouse. The items were acquired as part of a package deal of items commonly marketed together from the same retailer and acquired by DeskJobs for the purpose of being used together as a permanent workstation.

DeskJobs wants to know whether the computer, keyboard and mouse are separate items of property for depreciation purposes or components of a single item.

The computer, keyboard, and mouse are one item of property for depreciation purposes for the following reasons:

- The function of the desktop computer package is the processing, storing and display of digital content created or accessed or both using the computer, keyboard and mouse together. The desktop computer package is unable to perform its function without all the component items of the computer, keyboard, and mouse.
- While each component (the computer, keyboard and mouse) performs a function of its own, these functions are not independent functions but are integral or subsidiary functions in terms of the practical use to which the desktop computer is put (ie, the package's function).
- In this case, the computer, keyboard or mouse has no practical purpose or use without the other components.
- While the computer, keyboard and mouse are physically distinct, they are components acquired together intended to function together as a single integrated system.
- The fact that, in other circumstances, the computer, keyboard and mouse might have been used separately or with other compatible items, does not prevent them being part of a single item for depreciation purposes from DeskJob's perspective.

On these facts, the computer, keyboard and mouse cannot be considered entireties by themselves and separate items of property. Together, they comprise a single item of property.

Factual variations

The practical use to which an item is to be put by the taxpayer is crucial. Because of this, there will be situations where the integrated system indicator is less important in identifying the relevant item of property.

For example, a computer package might have been acquired because it is cost-effective, even if the items will not be used together. This could happen if, for example, a computer had a touchscreen or was a laptop, and the peripherals (keyboard and mouse) are to be used separately (and potentially with other computers). In such cases, there is no integrated system and the distinctness and completeness of each item is more obvious and determinative of what is the relevant item of property.

Each case needs to be assessed on its own facts.

Subsequent replacements or additions

The cost of any subsequent replacement of components of the package (eg, replacing the mouse with a similar mouse or replacing the mouse with an ergonomic mouse) will be treated according to established approaches to distinguishing between deductible repairs and capital improvements (see IS 12/03).

The cost of any subsequent additions to the computer package that improves the existing functionality of the integrated system (eg, another screen) are treated as an addition to the cost of the package, rather than as the cost of a separate item of property.

Varying the functionality

Items that vary the functionality of the integrated system, rather than improve its existing functionaity, may be separate items of property. If DeskJobs Ltd purchased a wireless-capable multifunctional printer at the same time as the desktop computer package, the printer could be a separate item of property for depreciation purposes for the following reasons:

- The printer has a separate function of printing, copying and scanning documents. It supplements or varies the function of the desktop computer package allowing the package to perform a specialist function (ie, output printed material).
- The desktop computer package can function without the printer.
- The functional aspects of the items suggest the printer is a separate item of property.
- Although the printer is unable to perform its printing function without the desktop computer package, this does not deprive it of its status as a separate item of property for depreciation purposes. It is functionally complete in that it includes all that is necessary to fulfil the particular notion of a "printer".
- The printer is also physically distinct from the desktop computer package. While, because of wireless capabilities, the printer is not unique in this, the same could be said of the components of the desktop computer package. However, the printer is not an essential part of the desktop computer package system in the same way as, say, the wireless mouse.

If the printer has a cost of not more than the threshold set in s EE 38 (currently $1,000) it may be able to be depreciated at the rate of 100%, provided the other requirements of that section are met.

Example | Tauira 4: Network computer system

Furniture Ltd is a nationwide chain of furniture retail stores. It acquires and sets up a new computer system with a central data processing and storage server and a network of remote "thin client" or "dumb" terminals located in its stores throughout Aotearoa New Zealand. That is, the terminals are simple low performance computers that are designed for remote connection with a server with limited capacity for operating independently of the server. The various components were sourced from different suppliers at around the same time and assembled over a period into a functioning network. The central server receives, processes and displays sales and other data sent to it over the network from the remote terminals.

Furniture Ltd wants to know whether each remote terminal is a separate item of property for depreciation purposes or part of a single item of property being the network computer system.

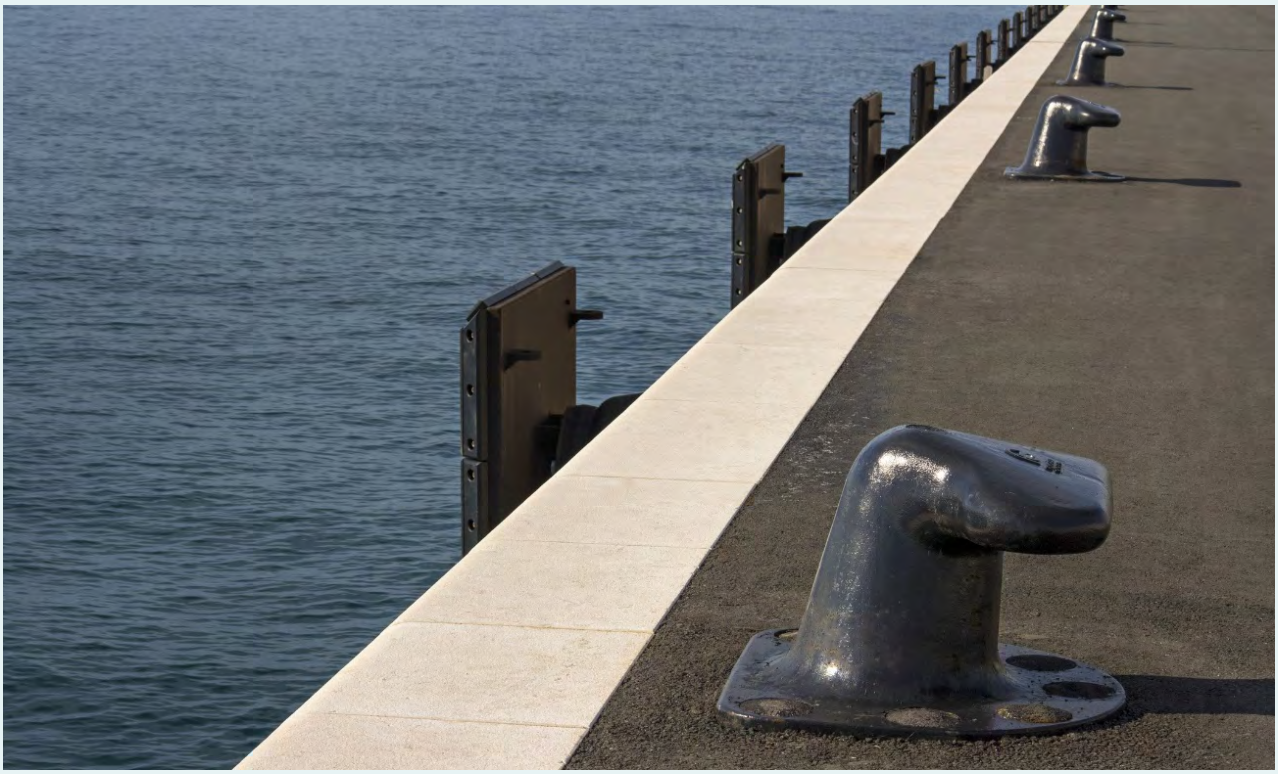
The central server and the remote terminals are a single item of property for depreciation purposes for the following reasons:

- The function of the central server is to receive, process and display data received from the remote terminals. The central server cannot function without the remote terminals.
- The terminals serve no practical purpose or use without the central server. That is, the terminals are not functionally distinct from each other or the central server.
- While the terminals and central server perform a function of their own, these functions are not independent functions but are integral or subsidiary functions in terms of the practical purpose to which the computer network is put.
- The server and remote terminals are, therefore, an integrated system. They were acquired at the same time and brought together so as to interact with each other and function in a unified way as a whole.
- It is not a case where it can be said that the terminals vary the function of the server.
- The fact each terminal and the central server may be interchangeable in that they could be used with other compatible items does not prevent them being part of a single item for depreciation purposes.

The terminals and the central server cannot be considered entireties by themselves and separate items of property. Together, they comprise a single item of property.

If the terminals were more capable of independent operation from the central server (ie, "thick client" or "smart" terminals) the integrated system indicator would carry less weight, but this change alone may not alter the conclusion reached in this example.

Example | Tauira 5: Marine fender system



Port Operator Ltd installed a fender system on a wharf generally used by container ships at the coastal port it operates. The fender system provides a buffer between the wharf and ships to prevent damage to the wharf and ships.

Port Operator installed the fender system because the port needs to cope with larger container ships. The wharf comprises steel piles, concrete beams and a concrete deck. The fender system comprises 29 assemblies spaced along the wharf, generally 5 metres apart. The number and spacing of the assemblies have been determined to ensure the fender system withstands and absorbs the energy generated by large ships. All 29 assemblies are required for the fender system to function.

Each assembly comprises:

- a large conical rubber fender;
- a low-frictional panel that contacts the ship's hull; and
- steel framing and galvanised chains to support the rubber fender and low- frictional panel.

Each assembly is fixed to the wharf with stainless steel bolts.

The fender system is designed for large container or cargo ships. It may not be suitable for differently configured vessels, which are usually required to provide their own fenders.

Port Operator wants to know whether the fender system is a separate item of property from the wharf for depreciation purposes. Both wharves and marine fender systems can be depreciable property, but the latter attracts a higher depreciation rate.

The fender system is a separate item of property for depreciation purposes for the following reasons:

- The fender system and wharf are physically distinct from each other in terms of relative size and ease of relocation (ie, the fender system is capable of being relocated to another wharf).
- The fender system has a separate function from that of the wharf. The function of the fender system is to provide a buffer between large container ships and the wharf. The function of the wharf is to provide a stable and level mooring for all vessels to facilitate the loading and unloading of cargo.

- The wharf is functionally complete – it can still function as a wharf without the fender system. While the fender system cannot function without the wharf it is functionally complete in that it includes all that is necessary to fulfil the particular notion of a "fender system".
- The separate functions and completeness of the wharf and the fender system suggest they are separate items of property.
- The fender system varies the performance of the wharf. It enables it to be used for a specialised purpose, namely the loading and unloading of container ships. This also suggests they are separate items of property.

A high degree of physical attachment exists between the fenders and wharf. However, having regard to all other relevant facts and circumstances, this does not, of itself, make them one item of property for depreciation purposes.

The fender system and wharf can each be considered an entirety, and each is a separate item of property.

Note that each of the 29 assemblies comprising the fender system is designed to work as part of an integrated system and does not have a discrete function when considered in isolation. Therefore, each assembly is not considered to be a separate item of property.

Example | Tauira 6: Drone used in aerial photography business

Photo Ltd recently acquired a remote-control drone for use in its aerial photography business. The drone has a built-in camera that cannot be purchased separately from the drone.

Photo Ltd wants to know whether the camera is a separate item of property for depreciation purposes or part of the drone. It also wants to know whether the drone's remote-control handset is a separate item of property for depreciation purposes or part of the drone.

On these facts, the built-in camera, drone, and remote-control handset are one item of property for depreciation purposes for the following reasons:

- Neither the built-in camera nor the handset has a practical purpose or use without the drone.
- The camera is unable to function separately from the drone and handset.
- Physically separating the camera from the drone is not possible without damage to both.
- The drone cannot function without the handset.
- The drone with the built–in camera and the handset is an integrated system with the drone, camera and handset all intended to function in a unified way together.

The lack of physical distinctness in this situation is particularly suggestive of the drone and the camera being (or being part of, with the handset) a single item of property.

If the drone had no built-in camera and had an action camera attached to it instead, the drone and the action camera would be separate items of property for depreciation purposes for the following reasons:

- The drone has a separate function from that of the camera and each is able to fulfil that function without the other. The drone functions as a remotely controlled aircraft. The action camera functions as a photographic device.
- The action camera would vary the performance of the drone. It would enable it to be used for a specialised purpose of taking aerial photographs or videos.
- The drone and the camera are each functionally complete and each separately fulfils the notion of a "drone" and "camera".

While a limited degree of physical connection exists between the drone and the camera this arises only when the drone is in use for aerial photography purposes. They are easily separated without damage to either. This physical connection on its own is not sufficient to prevent the drone and camera each being considered an entirety and each a separate item of property. While the two items may have been put together and interact to provide aerial photographic functionality, they have limited non-permanent physical connection, such that they have not become subsidiary components of an integrated system. When interacting they each vary the function of the other.

Example | Tauira 7: Solid-fill puncture-proof tyres

Contractor Ltd replaced the tyres on its front–end loader with solid-fill puncture-proof tyres. These are tyres that have been injected with a liquid that cures to form a soft rubber core. This eliminates flat tyres and blowouts, and the tyre pressure remains constant for the life of the tyres.

Contractor wants to know whether the solid-fill tyres are separate items of property from the front-end loader for depreciation purposes.

The solid fill tyres and the front-end loader are not separate items of property for depreciation purposes for the following reasons:

- The function of the front-end loader is that of a specialised wheeled vehicle for picking up and moving large quantities of materials, such as earth or sand. The tyres do not perform a different function, and do not vary the function of the loader.
- The front-end loader is unable to function without the tyres, whether treated with solid fill or not. The tyres do not have any practical purpose or use on their own.
- The tyres perform a function that is an integral or subsidiary part of the loader's function.
- The lack of a functional distinction between the loader and the tyres suggests they are not separate items of property.
- The tyres are firmly attached to the wheels and the wheels and loader are physically connected and are part of an integrated system of connected components intended to function together.
- The lack of a physical distinction between the loader and the tyres also suggests they are not separate items of property.

The front-end loader and the solid-fill tyres cannot be considered as entireties and separate items of property. Together, they comprise a single item of property.

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Legislative References | Tohutoro whakatureture

Income Tax Act 1976, s 108

Income Tax Act 2007, subpart EE (specifically, ss EE 1(2), EE 2 to EE 5, EE 6 to EE 11, EE 37, EE 38), s YA 1 ("commercial fit-out", "utilities distribution asset", "utilities distribution network", "utilities distribution network operator"), schedule 13.

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QB 20/01: Can owners of existing residential rental properties claim deductions for costs incurred to meet Healthy Homes standards? *Tax Information Bulletin* Vol 32, No 7 (August 2020): 126.
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Te hekenga wāriu: Depreciation (webpage, Inland Revenue, last updated 5 October 2023)
www.ird.govt.nz/income-tax/income-tax-for-businesses-and-organisations/types-of-business-expenses/depreciation

Appendix – Legislation | Āpititanga – Whakature

EE 1 What this subpart does

...

When amount of depreciation loss arises

(2) A person has an amount of **depreciation loss** for an item for an income year if—

(a) the person owns an item of property, as described in sections EE 2 to EE 5; and

(b) the item is depreciable property, as described in sections EE 6 to EE 8; and

(c) the item is used, or is available for use, by the person in the income year; and

(d) the amount of depreciation loss is calculated for the person, the item, and the income year under sections EE 9 to EE 11.

...

EE 6 What is depreciable property?

Description

(1) Depreciable property is property that, in normal circumstances, might reasonably be expected to decline in value while it is used or available for use—

(a) in deriving assessable income; or

(b) in carrying on a business for the purpose of deriving assessable income; or

(c) in deriving exempt income, and it is used in performing research and development activities.

Subsections (2) to (4) expand on this subsection.

Property: tangible

(2) An item of tangible property is depreciable property if—

(a) it is described by subsection (1); and

(b) it is not described by section EE 7.

Property: utilities distribution assets

(2B) For the purposes of this subpart, utilities distribution assets are separate items of property.

Property: intangible

(3) An item of intangible property is depreciable property if—

(a) it is within the definition of depreciable intangible property; and

(b) it is described by subsection (1); and

(c) it is not described by section EE 7.

Property: geothermal wells

(4) For the purposes of this subpart, a person who owns a geothermal well is, for the geothermal energy proving period, treated as acquiring the well as property that declines in value and is to be available for use in carrying on a business for the purpose of deriving assessable income.

EE 7 What is not depreciable property?

The following property is not **depreciable property**:

(a) Land other than depreciable intangible property, although buildings, fixtures, and the improvements listed in schedule 13 (Depreciable land improvements) are depreciable property if they are described by section EE 6(1):

(ab) a lease of land with a perpetual right of renewal:

(b) trading stock:

(c) livestock to which subpar EC (Valuation of livestock) applies:

(d) financial arrangements:

(e) excepted financial arrangements other than depreciable intangible property:

(f) property that will not decline in value, as far as its owner is concerned, because, when they dispose of it, they have a right to be compensated for any decline in its value:

(fb) property that is a piece of an item of depreciable property that is an aircraft or an aircraft engine, if the expenditure on the piece is treated under section DW 5(8) (Aircraft operators: aircraft engines and aircraft engine overhauls) as being expenditure incurred in carrying out an aircraft engine overhaul:

(fc) a utilities distribution network, to the extent to which it is treated as an item of property separate from the relevant utilities distribution assets:

(g) property that its owner chooses, under section EE 8, to treat as not depreciable:

(h) property that its owner chooses, under section EE 38, to deal with under that section:

(i) property for whose cost a person other than the property's owner is allowed a deduction:

(j) property for whose cost a person is allowed a deduction under a provision of this Act outside this subpart or under a provision of an earlier Act.

LEGAL DECISION – CASE SUMMARY

This section of the *TIB* sets out brief notes of recent tax decisions made by the Taxation Review Authority, the High Court, Court of Appeal, and the Supreme Court.

We've given full references to each case, including the citation details where it has already been reported. Details of the relevant Act and section will help you to quickly identify the legislation at issue. Short case summaries and keywords deliver the bare essentials for busy readers. The notes also outline the principal facts and grounds for the decision.

These case reviews do not set out Inland Revenue policy, nor do they represent our attitude to the decision. These are purely brief factual reviews of decisions for the general interest of our readers.

Commissioner's appeal to Court of Appeal successful: there is no right of appeal to a strike out by the TRA

Decision date: 05 February 2025

CSUM 25/04

Case

Commissioner of Inland Revenue [2025] NZCA 5

Legislative References

Taxation Review Authority Act 1994

Senior Courts Act 2016

Legal terms

Strike out.

Interlocutory decision [an interlocutory decision is a decision to manage the progress of a case before the Court prior to the substantive issues in the case being determined]

Summary

This decision is consistent with the outcome in two earlier decisions that interlocutory decisions of the TRA were not amenable to appeal (*MJ Wetherill* (2004) 21 NZTC 18,924 (CA) and *Jiao* (2009) 24 NZTC 23,763 (HC)). These cases were applied to conclude a strike out decision did not determine the Taxpayer's tax challenge. Rather it brought to challenge to an end without addressing the substantive tax issues raised by the challenge. "Determine" for the purposes of the TRA means decide the merits of the tax challenge and just the ending of a tax challenge. As a result, there was no right of appeal under the Taxation Review Authorities Act 1994 to interlocutory decisions.

Impact

This decision returns the law to the position as it was previously understood; that an interlocutory decision of the TRA does not determine a tax challenge even if it ends that tax challenge and so cannot be appealed.

Facts

Ms Kaur commenced proceeding in the TRA to challenge assessments by the CIR. Due to Ms Kaur failure to meet timetabling requirements the parties agreed that the TRA should issue "unless orders" which the TRA did with the consent of the parties. If either party failed to meet the timetable in the unless order, their pleadings would be struck out and the unless order sealed. This would have the effect that the tax challenge would be ended.

Ms Kaur failed to file her briefs of evidence with the TRA (although she did serve them on the CIR) and failed to file and serve an index of documents for an agreed common bundle. The TRA struck out her challenge on 19 October 2022 ([2022] NZTRA 3).

Because the strike out order had been sealed by the TRA, the TRA considered it was unable to revisit the order made (decision dated 9 Nov 2022 [2022] NZTRA 4). Ms Kaur lodged an appeal against the decision of the TRA. She subsequently also commenced a judicial review of the TRA's decision in case there was no right of appeal against the TRA's decision.

The High Court accepted there was a right of appeal (*Kaur v TRA and CIR* [2023] NZHC 2748). In deciding this, the High Court referred to s 56(4)(a) of the Senior Courts Act (that allows a decision striking out a proceedings to be appealed) to conclude there was no compelling reason the same approach should not be applied to strike out by an inferior court (such as the TRA).

Having concluded an appeal could be made, the High Court then considered whether to allow the appeal.

Noting the non-compliance was the fault of Ms Kaur's lawyer the High Court concluded "by a fine margin" to allow the appeal to the strike out.

The High Court also treated the appeal as a *de facto* application for relief from the effect of the unless orders (although no formal application for relief had been made) and considered relief could be granted by allowing the appeal.

The High Court did not decide on the application for a judicial review.

The CIR appealed to the Court of Appeal.

Issues

1. Was there a right to appeal from a strike out decision by the TRA?
2. If such a right exists, should the appeal to the strike out on these particular facts be allowed?
3. Could the High Court treat the appeal as a *de facto* application for relief?
4. If it could not be appealed, could the TRA's strike out decision be judicially reviewed?

Decision

The Court of Appeal affirmed its earlier decision in *Wetherill* that it is not possible to appeal interlocutory decisions by the TRA, such as a strike out decision:

> [35] There is no general right of appeal to the High Court from decisions of the TRA. As the courts have said before, the need for efficient administration of justice and finality in taxation matters required the right of appeal to be restricted.
>
> …
>
> [42] Although the interlocutory application at issue in *Wetherill* was not a strike-out application, and was of a relatively minor nature, the Court's reasoning and conclusion is clearly not so limited. **The Court considered that a right of appeal under s 26 would only arise following a final resolution of an objection on its merits. The Court's reasoning would suggest that no right of appeal arises in relation to strike-outs on procedural grounds. In such cases the taxpayer has not been unsuccessful on the merits of their objection, but rather on their failure to adhere to a timetabling direction or similar.** A right of appeal might exist, however, when an objection is struck out on the basis that it had no prospect of success. This would likely amount to a final decision on the merits and hence be appealable.
>
> …
>
> [45] **We agree with the Court in *Wetherill* and with the Commissioner in this case that the wider scheme of the TRAA supports the conclusion that a "determination" refers to a final resolution of an objection (or challenge) on its merits.** In addition to ss 3 and 25 (as referred to in Wetherill), ss 13 and 13A refer to the TRA's function as being to hear and determine objections and challenges. Sections 16 and 18 both refer to the "hearing and determination" of a proceeding or objection. Those provisions clearly suggest a determination would involve a hearing and assessment of the actual objection or challenge.35

> [46] Furthermore, ss 20 and 21A(2) of the TRAA both provide that if a party is neither present nor represented at the hearing of a proceeding the TRA may strike out the proceeding, determine the proceeding or adjourn the hearing. **The clear distinction between striking out and determining a proceeding is again consistent with the conclusion that a strike-out for procedural reasons is not a determination.**
>
> **...**
>
> [51] The matter at issue in this case and the TRA cases cited above is the definition of a "determination" for purposes of the TRAA, not which interlocutory decisions are appealable as of right and which require leave under the Senior Courts Act. The relevant provisions and context of the Senior Courts Act are materially different to the TRAA. **We do not agree that the language of s 56(4) can in effect be imported into ss 26 and 26A of the TRAA to support the proposition that parties should have a right of appeal against any strike-out (or dismissal) decision of the TRA**.
>
> ...
>
> [56] **For the above reasons we find that "determination" for the purposes of s 26A is limited to decisions that finally determine challenges on their merits. This excludes decisions that dispose of challenges other than on their merits, including by dismissal or strike-out.**
>
> [57] The strike-out decision of the TRA on 19 October 2022 was not a decision that finally determined Ms Kaur's challenge on the merits and was therefore not a determination for purposes of s 26A. There was accordingly no right of appeal to the High Court. The Judge therefore did not have jurisdiction to allow the appeal and the orders made must be set aside.
>
> [Emphasis added]

The Court concluded that even if there was a right to appeal in these circumstances, the appeal should not have been allowed (at [63]).

The Court considered the High Court also erred when it treated the appeal as a *de facto* application for relief from the TRA's sealed orders (at [64] to [65]).

The Court declined the taxpayer's invitation to determine the judicial review proceedings and referred these back to the High Court while urging the parties to "agree a sensible and cost-effective procedure to adopt" for the judicial review (at [71]).

TECHNICAL DECISION SUMMARY

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TDS 25/01: Sale of leasehold interests in residential and commercial units

Subjects | Kaupapa

Income tax: PIE rules; assets and income derived from development; whether still within the rules for a PIE

Taxation laws | Ture tāke

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

Summary of facts | Whakarāpopoto o Meka

1. A was a registered New Zealand limited partnership.
2. The majority limited partner of A was B Ltd. B Ltd was an incorporated company that was registered as a multi-rate portfolio investment entity (PIE).
3. A leased land from an unrelated third party and developed a number of apartments and commercial units (units) on the land under the Unit Titles Act 2010 (UTA). A sold the units to members of the public by first granting itself a sublease of each unit and then assigning the sublease to the purchaser (resident).
4. The Arrangement was the sale and purchase of strata estate in leasehold interests entered into between A and prospective residents of units, as well as commercial tenants.
5. Under the terms of the sale and purchase agreement, a portion of the purchase price (referred to as "Entry Rent") paid by a resident was allocated as consideration for the assignment of the sublease which A granted to itself with the effect that the resident became the new lessee under the sublease with A remaining as lessor.
6. In addition, an amount (referred to as "Exit Rent") is paid by a resident to A on disposal of their leasehold interest in the unit to a new purchaser. The Exit Rent was described in the lease agreement as being a contribution to the Landlord's general costs incurred in the supply of the use of the Unit and common facilities. The Exit Rent did not include ground lease payments.

Issues | Take

7. The main issues considered in this ruling were whether:
   - the assets, as listed below, fell within the permitted asset holdings for a PIE:
     - Ground lease interest in land
     - Strata leasehold estate in units prior to sale
     - Leasehold interest in infrastructure, common area buildings and or commercial units (subleased to third parties who were not associated).
   - the income, as listed below, fell within the permitted income categories for a PIE.
     - Sale proceeds derived from the sale of strata leasehold interests in the units
     - Rent derived from residential occupants including Entry Rent and Exit Rent
     - Sale proceeds derived from the sale of strata leasehold interests in any commercial units
     - Rent derived from any commercial tenants.

Decisions | Whakatau

8. The Tax Counsel Office (TCO) concluded:
    - the investments, as listed below, were permitted investment types under s HM 11(1)(a):
        - Ground lease interest in land;
        - Strata leasehold estate in units prior to sale;
        - Leasehold interest in infrastructure and commercial units but excluding any property that was "common property" as defined in s 5 of the Unit Titles Act 2010 and owned by the body corporate under s 54 of that Act.
    - the income, as listed below, met the criteria in s HM 12(1)(b), provided that the lessee under a lease was not associated with A or B Ltd under subpart YB:
        - Rent derived from residential occupants, including the Entry Rent and Exit Rent;
        - Rent derived from any commercial tenants
        - Sale proceeds derived from the sale of strata leasehold interests in the residential units;
        - Sale proceeds derived from the sale of strata leasehold interests in any commercial units.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: PIE income and asset requirements

9. Section HM 7 sets out the requirements that a PIE must meet and maintain for PIE status. In summary, a PIE must maintain the requirements in ss HM 8 to HM 20. The only provisions considered by TCO were ss HM 11 and HM 12.

PIE investment types under s HM 11

10. Under s HM 11, an entity's investments must, to the extent of 90% or more by value of its assets, be one of the types of investments listed below:
    - An interest in land:
    - A financial arrangement:
    - An excepted financial arrangement:
    - A right or option in relation to property listed above.
11. B Ltd had a majority share of the interests in A and A held the relevant assets relating to the Arrangement.
12. Under s HG 2(1)(b), a partner is treated as holding property that a partnership holds, in proportion to the partner's partnership share, and the partnership is treated as not holding the property. Therefore, in considering the investments held by B Ltd for the purposes of s HM 11, it was necessary to look through to the investments held by A.
13. TCO ascertained that B Ltd would be treated as holding the following interests of A :
    - A ground lease interest in land as lessee;
    - Strata estate in leasehold in the units constructed prior to their sale to residents;
    - A leasehold interest in infrastructure, common area buildings and commercial buildings/units (to be subleased to un-associated third parties).
14. TCO concluded that the ground lease interest, the strata leasehold estate in units and the leasehold interest in infrastructure and commercial units (but excluding any property that was "common property" as defined in s 5 of the UTA and owned by the body corporate under s 54 of UTA) was an interest in land under s HM 11. Section YA 1 defined "an interest in land" as an estate or interest in land and included a right to possession of the land, such as a licence to occupy.
15. Therefore, the leasehold interests were "interests in land" as they were estates in land. Accordingly, A had an "interest in land" under s HM 11(1)(a) in relation to the ground lease, the strata leasehold estate and the interests in infrastructure and commercial units (subject to the exclusion in [15]) which B Ltd was treated as holding under s HG 2.

Income types under s HM 12

16. Under s HM 12 income derived by an entity that wishes to satisfy the PIE requirements must, to the extent of 90% or more:
    - be derived from property referred to in s HM 11; and
    - consist of one of the following types of income:
        - a dividend (s HM 12(1)(b)(i)):
        - a replacement payment (s HM 12(1)(b)(ii)):
        - an amount under subpart EW treated as derived by the entity (s HM 12(1)(b)(iii)):
        - an amount derived from a lease of land (unless the lessee is associated with the entity) (s HM 12(1)(b)(iv)):
        - insurance, indemnity, or compensation amounts replacing an amount derived from a lease of land (s HM 12(1)(b)(ivb)):
        - an amount derived from the disposal of property referred to in s HM 11 (s HM 12(1)(b)(v)):
        - FIF income (s HM 12(1)(b)(vi)):
        - attributed PIE income (s HM 12(1)(b)(vii)):
        - a distribution from a superannuation fund (s HM 12(1)(b)(viii)):
        - an amount of income under ss CW 4 or CX 40 (s HM 12(1)(b)(ix)):
        - a rebate on a management fee (s HM 12(1)(b)(x)).
17. TCO ascertained that the following types of income would be derived by B Ltd:
    - Sale proceeds derived from the sale of strata estate in leasehold interests in the units.
    - Rent derived from residential occupants, including the Entry Rent and the Exit Rent.
    - Sale proceeds derived from the sale of strata estate in leasehold interests in any commercial units.
    - Rent derived from any commercial tenants.

Sales proceeds derived from the sale of the strata estate in leasehold interests in the units

18. TCO concluded that the sale proceeds derived from the sale of strata leasehold interests in the residential and commercial units was qualifying income under s HM 12 as these amounts were income derived from a lease of land under s HM 12(1)(b)(iv). While B Ltd derived income from the sale of the strata estate in leasehold interests in the Units to residents, the nature of the leasehold interests provided to residents meant that the residents were effectively leasing the units from A per the terms of the lease agreements that residents had to enter into with A alongside acquiring their leasehold interest. Accordingly, TCO considered that the land had been developed by A primarily for lease and that the sale proceeds were best characterised as amounts derived from a lease of land.
19. Section HM 12 is concerned with the income a PIE derives, which will be taxed under the PIE regime. For a partner in a partnership, that income will include their share of the income derived by the partnership. Therefore, TCO considered that s HG 2 was directly relevant and must be applied in the context of determining the nature of the income that was derived by an entity for the purposes of s HM 12.
20. Under s HG 2, B Ltd would be treated as carrying on the activities of A for the purposes of s HM 12. TCO noted that the Arrangement had some similarities with commercial property owned by listed property PIEs, where development of land and buildings may be undertaken to lease to tenants.
21. Alternatively, TCO considered the sale proceeds derived by B Ltd from the strata estate leasehold interests in the units would satisfy s HM 12(1)(b)(v) as they would be an amount derived from the disposal of property referred to in s HM 11. Importantly, TCO concluded that the sale proceeds were not derived from the development of land.

Entry Rent

22. TCO considered that the following principles applied in interpreting the phrase "derived from a lease" contained in s HM 12(1)(b)(iv):
    - Whether the amount is flowing, springing or emanating from a lease;
    - It does not matter whether the payment is stipulated in the lease itself or in a separate agreement;
    - There must be some real nexus between the grant of the lease and the payment;
    - In determining the nexus between the payment made to acquire something (for instance, a good or service), and the lease, consideration should be given to the nature of the business carried on by the lessee, the particular site on which the business is carried on, and the connection between what was acquired and the leased site;
    - The enjoyment of occupation under the lease must be essential or inseparable from what was obtained as a result of the payment.

23. Therefore, as the wording of s HM 12 only required that an amount of income was derived from a lease of land, TCO considered this was broad enough to cover the Entry Rent as it was paid by a resident in return for becoming the lessee under the sublease issued by A. There was a real nexus between the grant of the sublease and the payment of the Entry Rent as it was paid by a resident for the accompanying sublease to their leasehold interest. As a result of the payment of the Entry Rent (along with the Purchase Price), the resident became a lessee and was entitled to occupy their unit and use the common areas and facilities per the lease agreement.

Exit Rent

24. TCO considered that the Exit Rent appeared to be a payment of deferred rent under the lease as it related to the resident's occupation of their unit and their use of associated services and amenities (excluding amounts that were charged as monthly Outgoings). Therefore, it was necessary to consider whether this was an amount of income derived from a lease of land by A (the Exit Rent was arguably not an amount derived on disposal of an interest in land as it was derived by A rather than the resident selling the leasehold interest in their unit).

25. It was TCO's view that any additional maintenance, services and amenities provided to residents as part of their accommodation that was covered by the Exit Rent was directly connected to the resident's enjoyment of their unit under their lease. This was because the lease related not only to the unit but also to the right to use and enjoy the common areas as a whole, in conjunction with the other residents. This view was conditional on the lessee not being associated with B Ltd or A.

Sale of leasehold interests to commercial owners and rent derived from commercial third party operators

26. TCO considered that the same analysis outlined above in relation to the sale of leasehold interests in the residential units applied so that the sales proceeds were income under s HM 12(1)(b)(iv) as income derived from a lease of land.

27. In relation to rent derived by B Ltd from commercial businesses, this was clearly income derived from a lease of land under s HM 12(1)(b)(iv).

Conclusion on s HM 12

28. TCO concluded that sale proceeds derived from the sale of strata leasehold interests in the residential and commercial units was qualifying income under s HM 12 as these amounts were income derived from a lease of land under s HM 12(1)(b)(iv) or alternatively were income from the disposal of an interest in land under s HM 12(1)(b)(v).

29. TCO also concluded that the Entry Rent and the Exit Rent were income under s HM 12(1)(b)(iv) as income derived from a lease of land. It was further concluded that rent derived from any commercial tenants was also income under s HM 12(1)(b)(iv). TCO noted that s HM 12(1)(b)(iv) did not apply if the lessee under a lease was associated with the entity receiving the amount.

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Legal Services

Legal Services manages all disputed tax litigation and associated challenges to Inland Revenue's investigative and assessment process including declaratory judgment and judicial review litigation. They contribute the legal decisions and case notes on recent tax decisions made by the Taxation Review Authority and the courts.

Technical Standards

Technical Standards sits within Legal Services and contributes the standard practice statements which describe how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical operational issues arising out of the administration of the Inland Revenue Acts. They also produce determinations on standard costs and amortisation or depreciation rates for fixed life property used to produce income, as well as other statements on operational practice related to topical tax matters. Technical Standards also contributes to the "Your opportunity to comment" section.

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