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WEEKLY COMMENT: FRIDAY 28 MARCH 2014

1. The *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill* ("the November Bill"), which was introduced on 22 November 2013 contains a number of proposed amendments relating to black hole expenditure. The Finance and Expenditure Committee is due to report back on the Bill by 10 June 2014.

2. Last week I looked at expenditure on applying for a resource consent and the *Trustpower* case. This week I complete looking at the proposed black hole expenditure amendments.

3. The topics covered this week are:

   (a) Patent application not lodged or failed or withdrawn;

   (b) Expenses in application for plant variety rights;

   (c) Claw back for subsequent applications or disposal of application property;

   (d) Miscellaneous company administration costs: expenses in paying dividends;

   (e) Miscellaneous company administration costs: periodic company registration fees;

   (f) Miscellaneous company administration costs: meetings of shareholders.

Patent application not lodged or failed or withdrawn

4. The current s. DB 37 in the *Income Tax Act 2007* is headed "Expenses of failed or withdrawn patent". Under existing s. DB 37, *a person who applies for the grant* of a patent and is refused the grant or withdraws the application is allowed a deduction for expenditure:

   (a) That the person incurs in relation to the application; and

   (b) That would have been part of the cost of fixed life intangible property if the application had been granted; and

   (c) For which the person is not allowed a deduction under another provision.

5. The deduction is allocated to the income year in which the grant is refused or the application is withdrawn.

6. Clause 41 of the November Bill contains a proposal to change the heading of s. DB 37 to: "Expenses in application for patent". Clause 41 also contains a proposed new s. DB 37 itself, under which *a person who incurs expenditure for the purpose of applying for the grant* of a patent and does not obtain the grant because the application is not lodged or is withdrawn, or because the grant is refused, is allowed a deduction for the expenditure:

(a) That the person incurs in relation to the application or intended application; and

(b) That would have been part of the cost of depreciable property, or otherwise a deduction, if the application or intended application had been granted; and

(c) For which the person is not allowed a deduction under another provision.

7. The deduction in proposed replacement s. DB 37 is to be allocated to the income year in which the person decides not to lodge the application, withdraws the application, or is refused the grant.

8. The difference is that the proposed change will allow a deduction for an *intended application* that is abandoned, as opposed to an actual application. The other requirements in existing s. DB 37 are to be retained.

9. This amendment applies from the beginning of the 2014-15 income year.

Expenses in application for plant variety rights

10. Clause 42 of the November Bill contains a proposal to insert a new s. DB 40BA headed "Expenses in application for plant variety rights". A person who incurs expenditure for the purpose of applying for the grant of plant variety rights and does not obtain the grant because the application is not lodged or is withdrawn, or because the grant is refused, is allowed a deduction for the expenditure:

(a) That the person incurs in relation to the application or intended application; and

(b) That would have been part of the cost of fixed life intangible property, or otherwise a deduction, if the application or intended application had been granted; and

(c) For which the person is not allowed a deduction under another provision.

11. The deduction in proposed s. DB 40BA is to be allocated to the income year in which the person decides not to lodge the application, withdraws the application, or is refused the grant of plant variety rights.

12. This amendment also applies from the beginning of the 2014-15 income year.

Clawback for subsequent applications or disposal of application property

13. Clause 16 of the November Bill contains a proposal to insert a new s. CG 7B, which, as discussed last week, will claw back deductions claimed for resource consent applications. The proposed new s. CG 7B will also claw back deductions taken under proposed replacement s. DB 37 and new s. DB 40BA if:

(a) Expenditure is incurred for the purpose of applying for the grant of a patent or plant variety rights; and

(b) The application is not lodged or is withdrawn or the grant is refused; and

(c) A deduction is taken under s. DB 37 or s. DB 40BA for the expenditure; and

(d) Property, referred to as "application property", is acquired as a result of the expenditure; and

(e) The application property is disposed of for a consideration, or is used in the lodging of a patent application with a complete specification or in obtaining the grant of plant variety rights.

14. In the case where the application property is disposed of for a consideration, the amount that will be clawed back is the lesser of:

    (a) The amount of the consideration that is not income under any other provision in the Income Tax Act 2007; or

    (b) The total deductions claimed under s. DB 37 or s. DB 40BA.

15. In the case where the application property is subsequently used in the lodging of a patent application with a complete specification or in obtaining the grant of plant variety rights, the amount that will be clawed back is all of the deductions claimed under s. DB 37 or s. DB 40BA.

16. A proposed new s. EE 57(3)(cb) will result in the expenditure that is clawed back under s, CG 7B being included in the base value of the patent application, patent or plant variety rights for tax depreciation purposes.

17. A proposed amendment to s. EE 25(3)(a), in clause 54 of the November Bill, will mean that expenditure clawed back under s. CG 7B will be included in the cost of a subsequent plant variety rights application for the purpose of calculating the pro-rated deduction for the cost of a plant variety rights application that a taxpayer is allowed when they are granted plant variety rights.

18. The background to the claw back rule is explained as follows in the *Commentary* to the November Bill:

    "It is possible that after taking a deduction for expenditure incurred on an aborted or unsuccessful application for the grant of a resource consent, a patent or plant variety rights, that a taxpayer may use or sell that application property at a later date. In the case of selling application property, the taxpayer has conceptually derived income. A claw-back provision is necessary to preserve a neutral tax treatment because otherwise taxpayers could receive a deduction that is larger than the loss they have suffered.

    The tax treatment of expenditure on application property from an aborted or unsuccessful application that is later used in a successful application and expenditure on a first-time successful application should be neutral. In other words, expenditure on a depreciable intangible asset should be depreciated over the estimated useful life of the asset. That certain expenditure did not create a depreciable asset in the first instance does not change the fact that the expenditure has ultimately created depreciable intangible property. Continuing to allow an immediate deduction for such expenditure is not a neutral tax treatment. A claw-back provision will ensure that taxpayers do not receive a timing advantage from immediately deducting expenditure on the initially unsuccessful, but ultimately successful, application property instead of spreading depreciation deductions over the estimated useful life of the depreciable asset created."

19. The claw back rule and the inclusion of the expenditure in the base value for tax depreciation purposes and in the cost of plant variety rights will apply from the beginning of the 2014-15 income year.

Miscellaneous company administration costs: expenses in paying dividends

20. Clause 44 of the November Bill contains a proposal to insert a new s. DB 63, which will allow a company a deduction for expenditure incurred in:

    (a) Authorising, allocating, or processing, the payment of a dividend; or

(b) Resolving a dispute concerning a matter referred to in paragraph (a).

21. The explanation in the *Commentary* is as follows:

    Proposed new section DB 63 of the Income Tax Act 2007 allows companies a deduction for all direct costs associated with the payment of a dividend. This does not include the amount of the dividend itself. …

    The dividend payment process involves authorising, allocating and paying the dividend, as well as addressing any disputes arising over its allocation. Expenditure incurred during this process is a mixture of capital and revenue. However, requiring taxpayers to separately track or apportion this expenditure into its deductible and non-deductible constituent parts could result in disproportionate compliance costs and uncertainty for taxpayers."

22. The amendment will apply from the beginning of the 2014-15 income year.

Miscellaneous company administration costs: periodic company registration fees

23. Clause 44 of the November Bill also contains a proposal to insert a new s. DB 63B, which will allow a listed company a deduction for expenditure incurred as periodic fees of a recognised exchange for maintaining the registration of the company on the exchange.

24. It is noted in the *Commentary* that:

    "Listed companies incur expenditure on an annual listing fee to maintain registration on a recognised stock exchange. Allowing this expenditure to be deductible recognises that its benefit persists for one year only, and is a necessary expense for a listed company."

25. The amendment is to apply from the beginning of the 2014-15 income year.

Miscellaneous company administration costs: meetings of shareholders

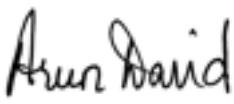
26. Clause 44 of the November Bill contains an additional proposal to insert a new s. DB 63C, which will allow a company a deduction for expenditure incurred in holding an annual meeting of the shareholders of the company to consider the affairs of the company.

27. However, a deduction will specifically be denied for expenditure incurred in holding a special or extraordinary meeting of the shareholders of the company.

28. It is stated in the *Commentary* that:

    "AGMs are an annual, recurring cost of doing business as a company, while special shareholder meetings are often held to consider a material change in the business of the company. Allowing a deduction for AGM costs while denying a deduction for special shareholder meeting costs ensures that taxpayers are not subject to disproportionate compliance costs or uncertainty over the tax treatment of shareholder meeting costs, and approximates the capital-revenue criteria."

29. The amendment will also apply from the beginning of the 2014-15 income year.



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