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LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

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LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(1) INCOME FROM AGREEMENTS TO GRANT OR TRANSFER LEASES

1. Consideration for agreement to grant, renew, extend, or transfer leasehold estate or licence

For amounts derived up to and including 31 March 2015

When a person (the **payee**) derives an amount as consideration for the agreement by the payee to the grant, renewal, extension, or transfer of a right (the **land right**) that is a leasehold estate, or a licence to use land, the amount is income of the payee, unless:

(a) The amount is derived by the payee:

(i) As the holder of a land right; and

(ii) As consideration for the transfer of the land right to the person paying the amount; or

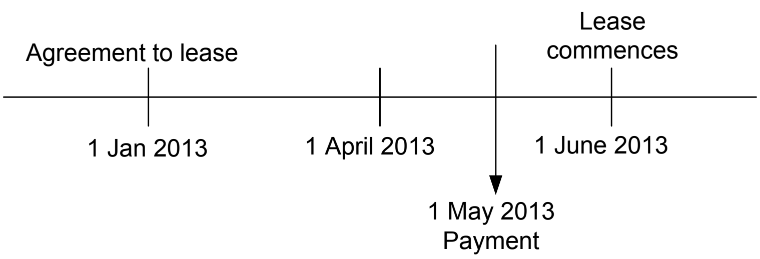
(b) The payee is a natural person and derives the amount as a tenant or licensee of residential premises whose expenditure on the residential premises does not meet the requirements of the general permission.

[**s. CC 1B** as inserted by **s. 7(1)** of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013* applying, under **s. 7(3)**, to an amount that is derived on or after 1 April 2013 in relation to a lease or licence entered, renewed, extended, or transferred on or after that date.

However, for amounts derived on or after 1 April 2015, s CC 1B has been replaced – see **page 3** below.]

Note: The amendments relating to lease inducement payments do not apply to an amount that is derived or incurred on or after 1 April 2013 in relation to a lease or licence entered, renewed, extended or transferred, before 1 April 2013.

Example (*in TIB Vol. 25 No. 9 October 2013*): A landlord and a tenant entered into a binding lease agreement on 1 January 2013. The landlord is liable to pay the tenant $100,000 on 1 May 2013 for the agreement to a lease. The lease commences on 1 June 2013.



The amendments relating to lease inducement payments do not apply to the $100,000 payment derived by the tenant. The lease is entered into before 1 April 2013 even though the payment is derived after the 1 April date. The tax treatment of the $100,000 lease inducement payment is determined under the general principles.

Note also: A "lease" includes an agreement to lease. The definition of "lease" in section YA 1 of the *Income Tax Act 2007* is a disposition that creates a leasehold estate. The definition of "leasehold estate" includes any estate, however created, other than a freehold estate. The definition of "estate" includes both a legal or equitable estate as well as a right to the possession of the land.

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(1) INCOME FROM AGREEMENTS TO GRANT OR TRANSFER LEASES (continued)

2. Consideration for agreement to grant, renew, extend, or transfer leasehold estate or licence

For amounts derived on or after 1 April 2015

An amount is income of a person (the **payee**), when the payee derives the amount:

1. In relation to a right (the **land right**) that is:

   (a) A leasehold estate not including a perpetual right of renewal; or

   (b) A licence to use land; and

2. As consideration for:

   (a) The agreement by the payee to the grant, renewal, extension, or transfer of the land right; or

   (b) The transfer of the land right from the holder of the land right to another person.

Unless 1 of the following 3 exemptions applies

3. Exemption 1: The amount is derived by the payee in the following circumstances, in which case it is not income:

   (a) The payee is the holder of the land right; and

   (b) The amount is consideration for the transfer of the land right to the person paying the amount; and

   (c) The amount is not sourced from funds provided, by the owner of the estate in land from which the land right is granted, for purposes that include obtaining the surrender or termination of the land right; and

   (d) Each of the payee and the person paying the amount is not associated with the owner of the estate in land from which the land right is granted; or

4. Exemption 2: The amount is derived by a payee who is a natural person who

   (a) Derives the amount as a tenant or licensee of residential premises, whose expenditure on the residential premises does not meet the requirements of the general permission; and

   (b) Is not associated with the owner of the estate in land from which the land right is granted; or

5. Exemption 3: The amount is derived by the payee as a capital contribution.

[**s. CC 1B** as replaced by **s. 10** of the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014* applying, under **s. 10(2)**, to an amount that is derived on or after 1 April 2015.]

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(1) INCOME FROM AGREEMENTS TO GRANT OR TRANSFER LEASES (continued)

3. What land rights and payments the new rules apply to

Both sets of rules – i.e. the rules in existing s. CC 1B that applies until 31 March 2015, and the rules in replacement s. CC 1B that applies from 1 April 2015 onwards – apply to **a land right that is a leasehold estate or a licence to use land**.

Explanation in Tax Information Bulletin Vol. 25 No. 9 October 2013

The term "leasehold estate" is defined broadly in section YA 1 to include any estate, however created, other than a freehold estate. The charging provision, therefore, does not apply to payments from a freehold estate in land, such as the proceeds from the sale of land. The charging provision applies broadly because it only focuses on the person who receives the payment—the payee. The payer is not relevant. If a person receives a lease inducement payment on behalf of another person, the existing nominee rules in section YB 21 apply to treat the amount as derived by that other person.

However, the **replacement s. CC 1B excludes a leasehold estate that has a perpetual right of renewal from the ambit of the rules from 1 April 2015**:

It was originally noted on page 88 of the *Commentary* that the recipient of a payment for a perpetually renewable lease will continue to be taxed under s. CC 1. Officials were of the view that such a payment (for example, a lease premium) is easily substitutable for taxable rent payments on a perpetually renewable lease that are periodically reset to market levels.

However, following submissions received that Glasgow-type leases (with the usual term of 7, 12 or 21 years), which are renewable in perpetuity, are more akin to freehold estates, officials recommended that s. CC 1B (and s. CC 1C – see further at **page 12** below) should excluded payments from the transfer or surrender of Glasgow leases. (Note that the amendment to s. CC 1C in relation to lease surrenders) applies from 1 April 2013 – see further at **page 11** below.)

The original s. CC 1B did not apply to actual lease transfer payments – it only applied to payments to agree to a transfer:

The original rules in existing s. CC 1B that apply from 1 April 2013 to 31 March 2015 only captured the consideration received for *agreeing* to the transfer of a land right. The original rules do not apply to an amount derived by the holder of the land right as consideration for the *actual transfer* of the land right to the payer of the consideration. Therefore, an amount paid by an assignor to get the assignee to agree to the transfer will be caught by the original rules, but not for the actual transfer.

Officials noted in the Commentary that under pre-existing rules (before s. CC 1B was enacted), lease transfer payments are generally non-taxable to the commercial tenant recipient and deductible to the incoming commercial tenant under the depreciation rules.

Examples of **payments that are taxable from 1 April 2013** under existing s. CC 1B include:

- A payment from a landlord (lessor) to a tenant (lessee);
- A payment from a tenant (sub-lessor) to a sub-tenant (sub-lessee); or
- A payment from a tenant (assignor) to a new tenant (assignee).

Examples of payments that are **not taxable** under existing s. CC 1B include:

- A lease transfer payment received by an assignor from an assignee for the assignment of an existing lease is not taxable under existing s. CC 1B. (Such a payment is not an "inducement".)

[*Tax Information Bulletin* Vol. 25 No. 9 October 2013, the *Commentary* to the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill* pages 84-86 and the *Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill* page 191-192]

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(1) INCOME FROM AGREEMENTS TO GRANT OR TRANSFER LEASES (continued)

3. What land rights and payments the new rules apply to (continued)

The replacement s. CC 1B applies to actual lease transfer payments – but only in limited circumstances:

Examples of **payments that are taxable from 1 April 2015** under replacement s. CC 1B include:

- A lease transfer payment received by an assignor (who holds the land right) from an assignee (to whom the land right is being transferred) for the assignment of an exiting lease will be taxable, under replacement s. CC 1B from 1 April 2015, unless:
  - (a) Either:
    - (i) The payment is not sourced from funds provided by the owner of the estate in land from which the land right is granted; or
    - (ii) If the payment is sourced from funds provided by the owner of the estate in land from which the land right is granted, the funds provided by the owner were not provided for purposes that include obtaining the surrender or termination of the land right; and
  - (b) Neither the payee nor the payer is not associated with the owner of the estate in land from which the land right is granted.
- The *Commentary* to the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill* initially identified two situations when lease transfer payments that are substitutable for lease surrender payments will be taxable to the payee. They are:
  - (a) If the amount is sourced directly or indirectly from funds provided by the owner of the estate in land from which the land right is granted – for example, where the landlord provides funds to the new tenant and the new tenant (assignee of the lease) uses the funds to pay the exiting tenant (the assignor of the lease): the exiting tenant (the assignor) will be taxed on the payment;
  - (b) If the person paying the amount is associated with the owner of the estate in land from which the land right is granted – for example, where the landlord is associated with the new tenant and the new tenant (assignee of the lease) pays the exiting tenant (the assignor of the lease): the exiting tenant (the assignor) will be taxed on the payment.
- However, following submissions the taxing provision was qualified with the requirement that funds provided by the owner had to be provided "for purposes that include obtaining the surrender or termination of the land right":
  - (a) Officials agreed that the original scope of section that taxed payments sourced directly or indirectly from funds provided by the landlord was too wide. Officials agreed that situations involving an arm's-length transaction between the landlord and the incoming tenant should not be caught, and the provision was amended accordingly.
  - (b) The particular submission that gave rise to the change was that lease transfer payments could be taxable to an outgoing tenant who had no knowledge or control over the arrangement. For example, if the landlord makes a loan to the incoming tenant to enable the new tenant to purchase the outgoing tenant's business (including the lease), the lease transfer payment made by the incoming tenant as part of the business sale would be taxable.

[The *Commentary* to the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill* p. 84-86 and *Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill* p. 195]

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(1) INCOME FROM AGREEMENTS TO GRANT OR TRANSFER LEASES (continued)

3. What land rights and payments the new rules apply to (continued)

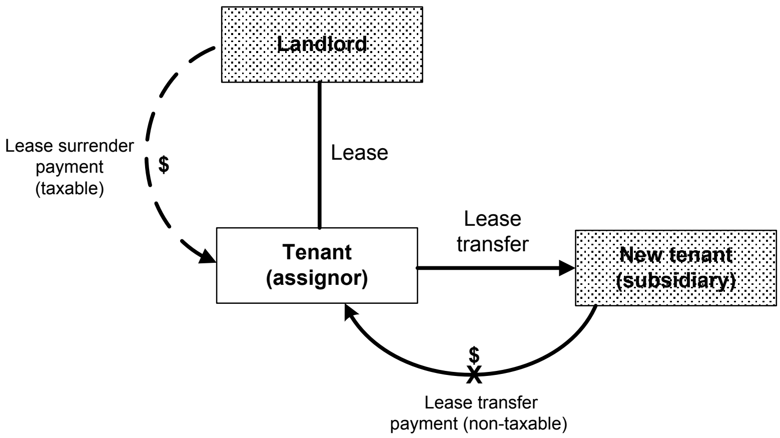
The following example was provided in the *Commentary* to the Bill to highlight the need for the amendment to s. CC 1B.

Example

On 1 April 2015, a landlord and a tenant enter into a 10-year lease. After three years, the landlord expands its business to retail, by setting up a subsidiary company. The landlord wishes the tenant to exit the lease so that the subsidiary company can use the premises to carry on its retail business.

If the landlord pays a lease surrender payment to the tenant, the payment is taxable to the tenant and deductible to the landlord.

A subsidiary company of the landlord and the tenant enter into an agreement to transfer the lease. The subsidiary company pays the tenant $100,000 for the transfer.



Under the current rules, the lease transfer payment of $100,000 is deductible to the subsidiary company over the remaining seven years under the depreciation rules. The lease transfer payment is non-taxable to the exiting tenant. The exiting tenant is $28,000 ($100,000 x 28%) better off than receiving a lease surrender payment from the landlord.

[*Commentary* to the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill* page 83]

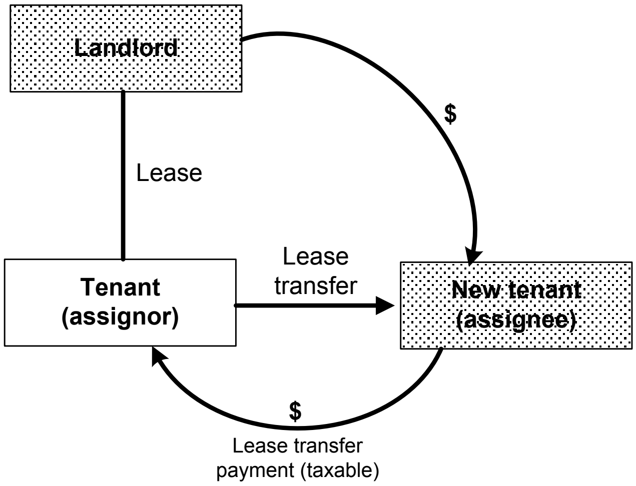
LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(1) INCOME FROM AGREEMENTS TO GRANT OR TRANSFER LEASES (continued)

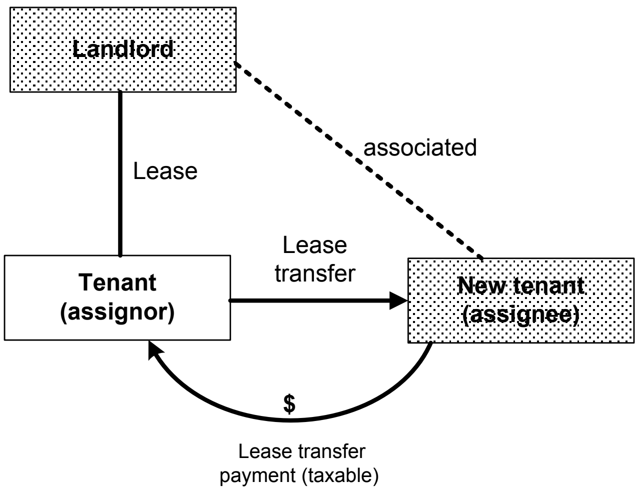
3. What land rights and payments the new rules apply to (continued)

It is noted in the *Commentary* that there are two situations when lease transfer payments that are substitutable for lease surrender payments will be taxable to the payee. They are:

if the amount is sourced directly or indirectly from funds provided by the owner of the estate in land from which the land right is granted.



if the person paying the amount is associated with the owner of the estate in land from which the land right is granted.



An exception for a tenant or a licensee of residential premises will apply to the two situations described above. The amount is not income if the payee is a natural person (individual) and derives the amount as a tenant or licensee of residential premises whose expenditure on the residential premises does not meet the requirements of the general permission (proposed section CC 1B(4)(a)). This exclusion is intended to provide a consistent tax treatment with that for lease surrender payments in section CC 1C.

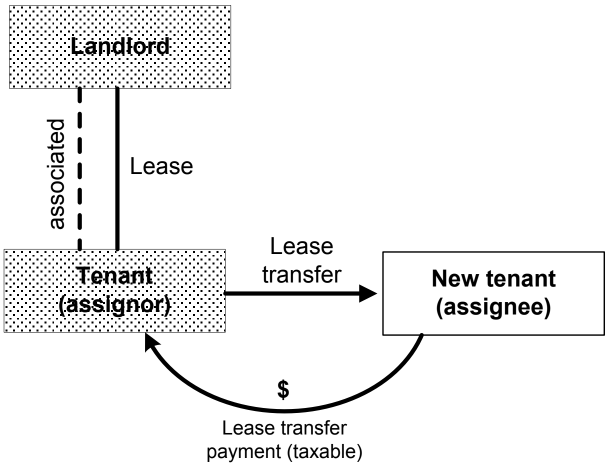
[*Commentary* to the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill* page 85]

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(1) INCOME FROM AGREEMENTS TO GRANT OR TRANSFER LEASES (continued)

3. What land rights and payments the new rules apply to (continued)

The *Commentary* goes on to state that another situation when lease transfer payments will be made taxable is payments that are substitutable for lease premium payments. In particular, if the payee is associated with the owner of the estate in land from which the land right is granted, lease transfer payments will be taxable.



This would prevent a landlord setting up a lease with a low rent with their associate and, as part of this arrangement, the associated tenant transfers the lease to a non-associated tenant and receives a non-taxable lease transfer payment.

Taxing a lease transfer payment in such situation will supplement the existing anti-avoidance provision in section GC 5, which allows the Commissioner to set an adequate level of rent for leases between associates.

[*Commentary* to the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill* page 86]

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(1) INCOME FROM AGREEMENTS TO GRANT OR TRANSFER LEASES (continued)

3. What land rights and payments the new rules apply to (continued)

Both sets of rules – i.e. the rules in existing s. CC 1B that applies until 31 March 2015, and the rules in replacement a. CC 1B that applies from 1 April 2015 onwards – contain exemptions for amounts received by a **natural person tenant or licensee of residential premises**. However, the exemption has an additional limitation in the replacement s. CC 1B.

Payments that are not taxable to an exiting residential tenant under **existing s. CC 1B** are as follows:

In general, an exiting tenant/ payee who is a natural person and a residential tenant or licensee will not be taxed on amounts received that are akin to lease surrender payments from a landlord (as described in the 2 situations identified in the Commentary and discussed above – i.e. where the landlord provides funds to the new tenant to pay to the exiting tenant, or where the new tenant/assignee is associated with the landlord).

The explanation in TIB Vol. 25 No. 9 October 2013 is that an individual tenant or a licensee of residential premises is not allowed a deduction for payments of rent because they do not meet the general permission in section DA 1 and the private limitation in section DA 2(2). On the other hand, an accommodation provider, who is not a natural person, is subject to section CC 1B because they would typically be allowed a deduction for payments of rent under the general permission.

The explanation in TIB Vol. 25 No. 9 October 2013 continues to state, however, that if there is a concurrent use of the land right for residential and business purposes, the amount is apportioned accordingly. The amount relating to business purposes is taxable under section CC 1B to the extent that a tenant or a licensee whose expenditure on the premises is allowed a deduction under the general permission in section DA 1.

Payments not taxable to an exiting residential tenant under **replacement s. CC 1B** are as follows:

The exiting residential tenant must not be associated with the landlord. Apparently this additional limitation is to counter payments that are substitutable for lease premium payments. The payment by the new tenant (the assignee of the lease) to the exiting tenant (the assignor of the lease) could be a substitute for a payment to the landlord (because the exiting tenant is associated with the landlord), which would in effect be a premium on the lease.

It is stated in the *Commentary* that:

“This would prevent a landlord setting up a lease with a low rent with their associate and, as part of this arrangement, the associated tenant transfers the lease to a non-associated tenant and receives a non-taxable lease transfer payment.

Taxing a lease transfer payment in such situation will supplement the existing anti-avoidance provision in section GC 5, which allows the Commissioner to set an adequate level of rent for leases between associates.”

[*Tax Information Bulletin* Vol. 25 No. 9 October 2013 and the *Commentary* to the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill* pages 84-86]

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(1) INCOME FROM AGREEMENTS TO GRANT OR TRANSFER LEASES (continued)

3. What land rights and payments the new rules apply to (continued)

The **tax treatment when there are overlapping taxing provisions** is discussed as follows in TIB Vol. 25 No. 9 October 2013:

Note that some land-related lease payments can be subject to more than one income-charging provision in the Income Tax Act 2007. For example, lease premiums are taxable under sections CC 1 and CC 1B and contributions for fit-out costs are taxable under sections CC 1B and CG 8. However, the tax treatment of amounts that are already subject to sections CC 1 and CG 8, which relate to income from land or capital contributions respectively, do not change. The amount is included in income only once (section BD 3(6)) and the new timing rule for lease inducement payments in section EI 4B does not apply to an amount that is income under section CC 1 and CG 8 (section EI 4B(2)).

This problem has been partially corrected by the replacement s. CC 1B: <u>From 1 April 2015, an amount that is subject to the existing capital contribution rules will not be taxable under replacement s. CC 1B</u>. A capital contribution will continue to be income under section CG 8 and spread evenly over 10 years unless the payee chooses to reduce the cost base of the depreciable property under section DB 64.

[*Tax Information Bulletin* Vol. 25 No. 9 October 2013 and the *Commentary* to the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill* pages 84-86]

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(1) INCOME FROM AGREEMENTS TO GRANT OR TO SURRENDER LEASES (continued)

4. Consideration for agreement to surrender leasehold estate or terminate licence

1. An amount is income of a person (the **payee**) when the payee:
   (a) Is the owner of:
      (i) An estate in land from which is granted a right (the **land right**) that is a leasehold estate not including a perpetual right of renewal, or is a licence to use land; or
      (ii) The land right; and
   (b) Derives the amount as consideration for the agreement by the payee to the surrender or termination of the land right.
2. The amount is not income if the payee:
   (a) Is a natural person; and
   (b) Derives the amount as a tenant or licensee of residential premises whose expenditure on the residential premises does not meet the requirements of the general permission.

[**s. CC 1C(1)** as replaced by **s. 11** of the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014* applying to an amount that is derived on or after 1 April 2013, and **s. CC 1C(2)** as inserted by **s. 7(2)** of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013* applying to an amount that is derived on or after 1 April 2013.]

<u>Explanation of original s. CC 1C(1) (prior to replacement) in TIB Vol. 25 No. 9 October 2013, p 31-32:</u>

1. New section CC 1C provides that if a person (the payee) derives an amount as a consideration for their agreement to the surrender or termination of a right (the land right) that is a leasehold estate or licence to use land, the amount is taxable to the payee. The payee must be one of the following:
   (a) The person who owns the estate in land from which the land right is granted; or
   (b) The person who owns the land right.
2. In most cases, lease surrender payments are made by a tenant to a landlord to surrender an existing lease. However, the charging provision also applies if the payment is made by the landlord to the tenant for them to surrender an existing lease.
3. Examples of payments that are taxable under s. CC 1C include:
   - A payment from a landlord (lessor) to a tenant (lessee);
   - A payment from a tenant (lessee) to a landlord (lessor);
   - A payment from a tenant (sub-lessor) to a sub-tenant (sub-lessee);
   - A payment from a sub-tenant (sub-lessee) to a tenant (sub-lessor).
4. If a person receives a lease surrender payment on behalf of another person, the existing nominee rules in s. YB 21 apply to treat the amount as derived by that other person.
5. The charging provision does not apply to an amount derived in relation to a freehold estate in land, such as the proceeds from the sale of land.
6. The reference to an "amount" uses the definition of "amount" in s. YA 1 which includes any amount in money's worth. The charging provision therefore includes consideration that is other than cash.

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(1) INCOME FROM AGREEMENTS TO GRANT OR TO SURRENDER LEASES (continued)

4. Consideration for agreement to surrender leasehold estate or terminate licence (continued)

Explanation of original s. CC 1C(2) in TIB Vol. 25 No. 9 October 2013, p 32:

An exception for a tenant or a licensee of residential premises applies. The amount is not income if the payee is a natural person (an individual) and derives the amount as a tenant or licensee of residential premises whose expenditure on the residential premises does not meet the requirements of the general permission.

This exclusion is intended to provide a consistent tax treatment of income and deductions for a tenant or a licensee of residential premises. An individual tenant or a licensee of residential premises is not allowed a deduction for payments of rent because they do not meet the general permission in section DA 1 and the private limitation in section DA 2(2). On the other hand, an accommodation provider, that is not a natural person (ie, they are a company), is subject to section CC 1C because they would typically be allowed a deduction for payments of rent under the general permission.

If there is a concurrent use of the land right for residential and business purposes, the amount is apportioned accordingly. The amount relating to a business purpose is taxable under section CC 1C to the extent that a tenant or a licensee whose expenditure on the premises is allowed a deduction under the general permission in section DA 1.

Additional amendment following the Officials' Report

As noted on **page 4** above, following submissions received that Glasgow-type leases (with the usual term of 7, 12 or 21 years), which are renewable in perpetuity, are more akin to freehold estates, officials recommended that s. CC 1C (and s. CC 1B – see further at **page 4** above) should exclude payments from the transfer or surrender of Glasgow leases. The amendment to s. CC 1C in relation to lease surrenders applies from 1 April 2013.

[*Tax Information Bulletin* Vol. 25 No. 9 October 2013 and the *Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill* p. 191-192]

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(2) EXPENDITURE ON AGREEMENTS TO GRANT OR TO SURRENDER LEASES

1. Expenditure on agreement to grant, renew, extend, or transfer leasehold estate or licence

A person (the **payer**) is allowed a deduction for an amount of expenditure incurred by the person as consideration for the agreement by another person (the **payee**) to the grant, renewal, extension, or transfer of a right (the **land right**) that is a leasehold estate (not including a perpetual right of renewal for an amount incurred on or after 1 April 2015 – see below), or a licence to use land if:

(a) The payer is the person who owns:

(i) The land right; or

(ii) The estate in land from which the land right is granted; and

(b) The payee is the person who is obtaining the land right.

This section overrides the capital limitation. The general permission must still be satisfied and the other general limitations still apply.

Note: This deduction provision allows deductions for other forms of lease inducements, in particular, contributions for fit-out costs. A consequence of this is that the timing rule for deductions in new section EI 4B (discussed below) applies to these payments. Refer to the example on **page 21** below. [*TIB* Vo. 25 No. 9 October 2013, page 28]

[**s. DB 20B** as inserted by **s. 27(1)** of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013* applying to an amount that is incurred on or after 1 April 2013 in relation to a lease or licence entered, renewed, extended, or transferred on or after that date;

And as amended by **s. 44** of the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014* applying to an amount incurred on or after 1 April 2015 by excluding perpetual right of renewal from being a leasehold estate that is a ‘land right’ for the purposes of this section.]

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(2) EXPENDITURE ON AGREEMENTS TO GRANT OR TO SURRENDER LEASES (continued)

2. Expenditure on agreement to surrender leasehold estate or terminate licence

A person (the **payer**) is allowed a deduction for an amount of expenditure incurred by the person as consideration for the agreement by another person (the **payee**) to the surrender or termination of a right (the **land right**) that is a leasehold estate not including a perpetual right of renewal or licence to use land, if:

(a) The payer is a person who owns the land right or the estate in land from which the land right is granted; and

(b) The payee is a person who owns the estate in land from which the land right is granted or who owns the land right.

This section overrides the capital limitation. The general permission must still be satisfied and the other general limitations still apply.

Note: No specific timing provision is provided for lease surrender payments (the spreading rules discussed in **page 15** onwards below apply to lease inducements). Generally, income and deductions for lease surrender payments are allocated to the income year in which the amount is derived or incurred. There would normally be no remaining period of the land right over which the amount can be spread at the time the lease surrender payment is derived or incurred. [*TIB* Vol. 25 No. 9, page 32]

[**s. DB 20C** as inserted by **s. 27(2)** of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013* applying to an amount that is incurred on or after 1 April 2013; and as amended by **s. 45** of the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014* also applying to an amount incurred on or after 1 April 2013 by excluding perpetual right of renewal from being a leasehold estate that is a 'land right' for the purposes of this section.]

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(3) THE SPREADING RULES FOR LEASE INDUCEMENT PAYMENTS

1. What the spreading rule applies to and the main spreading rule

1. The spreading rules apply to an amount that is incurred or derived on or after 1 April 2013 in relation to a lease or licence entered, renewed, extended, or transferred on or after that date.

2. The spreading rules apply to an amount that is income derived under s. CC 1B or expenditure incurred under s. DB 20B (i.e. essentially inducements), in an income year:
   (a) In relation to a right (the **land right**) that is a leasehold estate or a licence to use land; and
   (b) In relation to a period (the **spreading period**):
      (i) Beginning with the commencement, or a renewal or extension, of the land right; and
      (ii) Ending before the earliest following date on which the land right may be terminated, or may expire, if not extended or renewed.

3. The main spreading rules are:
   (a) If the amount is incurred or derived before the end of the spreading period, the amount is allocated in equal portions to each month that:
      (i) Includes part of the spreading period; and
      (ii) Ends after the amount is incurred or derived; and
      (iii) Is included in an income year ending within 50 years from the beginning of the spreading period; and
   (b) If the amount is incurred or derived at, or after the end of, the spreading period, the amount is allocated to the income year in which it is incurred or derived.

[**s. EI 4B(1) & (3)** as inserted by **s. 48(1)** of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013* applying, under **s. 48(2)**, to an amount that is incurred derived on or after 1 April 2013 in relation to a lease or licence entered, renewed, extended, or transferred on or after that date.]

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(3) THE SPREADING RULE FOR LEASE INDUCEMENT PAYMENTS (continued)

2. Qualifications to the spreading rule

1. When a person ceases, in an income year, to hold a land right, or the estate in land from which the land right is granted, all of the remaining income that should be spread is allocated to that year (the **balance year**) if:
   (a) At the beginning of the balance year, the person held the land right, or the estate in land from which the land right is granted; and
   (b) In the balance year, the person ceases to hold the land right, or the estate in land from which the land right is granted; and
   (c) The remaining income would be allocated under the spreading rules to an income year:
      (i) Ending before, or including, the end of the spreading period; and
      (ii) After the balance year.

2. When a person (together with associated persons) ceases, in an income year, to hold both a land right and the estate in land from which the land right is granted, any remaining deduction that should be spread is allocated to that year (the **balance year**) if:
   (a) At the beginning of the balance year, either or both of the land right and the estate in land from which the land right is granted are held by the person or by an associated person; and
   (b) At the end of the balance year, neither of the land right and the estate in land from which the land right is granted are held by the person or by an associated person; and
   (c) The remaining deduction would be allocated under the spreading rules to an income year:
      (i) Ending before, or including, the end of the spreading period; and
      (ii) After the balance year.

3. When a land right is surrendered or terminated, the holder of the estate in land from which the land right was granted must allocate the remaining deduction to that year (the **balance year**) if:
   (a) The person (the **affected person**) would ordinarily have allocated the remaining deduction to a spreading period under the general rule in s. EI 4B(3); and
   (b) The affected person holds the estate in land from which the land right was granted; and
   (c) The land right is surrendered or terminated in the balance year.

Note: These specific qualifying rules override the general spreading rule in s. EI 4B(3) on **page 15** above.

[**s. EI 4B(4), (5) & (6)** as inserted by **s. 48(1)** of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013* applying to an amount that is incurred or derived on or after 1 April 2013 in relation to a lease or licence entered, renewed, extended, or transferred on or after that date; and **s. EI 4B(5B)** as inserted by **s. 70** (in relation to a land right surrendered or terminated) of the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014* also applying to an amount that is incurred or derived on or after 1 April 2013 in relation to a lease or licence entered, renewed, extended, or transferred on or after that date.]

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(3) THE SPREADING RULE FOR LEASE INDUCEMENT PAYMENTS (continued)

2. Qualifications to the spreading rule (continued)

Section EI 4B allows spreading of income and deductions for the lease inducement payment over the term of the relevant lease. An exception to this is when a person ceases to hold the lease or land from which the lease is granted, before the end of the lease term. However, section EI 4B(5) does not provide a wash-up of deductions for landlords if a lease is terminated early (for example, for reasons of insolvency); the landlord is still required to spread deductions over the original term of the lease. This outcome is inconsistent with the policy rationale for having the wash-up mechanism. For consistency, a wash-up mechanism for lease inducement deductions for landlords (that is, lessors and sub-lessors) should be provided in section EI 4B(5B).

Officials agreed it would be consistent with the policy of the wash-up provision in section EI 4B(5) to allow a landlord to receive the balance of deductions for a lease inducement payment, if the lease is terminated early. This would be consistent with the treatment of a lessee who is taxed on the balance of income from a lease inducement payment if the lease is terminated early.

[*Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill* p. 197-198]

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(3) THE SPREADING RULE FOR LEASE INDUCEMENT PAYMENTS (continued)

3. TIB explanation of the spreading rule

<u>The spreading period is an initial fixed period and is not adjusted for later changes</u>

The "spreading period" means a period that:

- Begins with the commencement, or a renewal or extension, of the land right; and
- Ends before the earliest following date on which the land right may be terminated, or may expire, if not extended or renewed.

In other words, the spreading period is an initial fixed period set either at the grant, renewal or extension of the land right. The rationale for this approach is to avoid complexities around adjusting the spreading period (and relevant income and deduction allocations) when the initial fixed period is later modified, renewed or extended. If there is a payment for a renewal or extension of the land right, the payment is spread over the fixed renewal or extension period because that period is regarded as a separate spreading period.

Example 1

A landlord and a tenant enter into a 5-year lease, which includes two 5-year renewal rights. The lease commences on 1 April 2013. On the same day, the tenant receives a lease inducement payment from the landlord.

The spreading period of the lease inducement payment, which is subject to sections CC 1B and DB 20B, is from 1 April 2013 (being the commencement date of the lease) to 31 March 2018 (being the earliest following date on which the lease expires).

Example 2

Following on from the above example, in March 2018, the tenant decides to renew the lease for another 5 years (from 1 April 2018 to 31 March 2023). In January 2022, there is an oversupply of leases in the market. The tenant wants to move to other premises for a lower rent. Knowing this, the landlord makes a lease inducement payment to the tenant for the renewal of the lease for another 5 years (from 1 April 2023 to 31 March 2028). The tenant renews the lease for another 5 years.

The spreading period of the second lease inducement payment is from 1 April 2023 (being the commencement date of the second renewal period) to 31 March 2028 (being the earliest following date on which the lease expires). Although the payment was made in January 2022, the tenant derives the payment in relation to the second renewal period of the lease.

[*Tax Information Bulletin* Vol. 25 No. 9 October 2013 page 28].

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(3) THE SPREADING RULE FOR LEASE INDUCEMENT PAYMENTS (continued)

3. TIB explanation of the spreading rule (continued)

The amount is allocated to the spreading period even when is is incurred or derived earlier

Section EI 4B(3)(a) allocates income and deductions for lease inducement payments. The amount of income and deductions is allocated proportionately to the number of months in an income year over the spreading period.

Given that lease inducement payments are generally made at the commencement of a land right, the amount is allocated evenly over the spreading period. Even when the amount is derived or incurred before the commencement of the land right, the amount is allocated in relation to the spreading period, not when the amount is incurred or derived.

Example

On 1 April 2013, a tenant receives $100,000 from a landlord as consideration for the agreement to enter into a 10-year lease that commences on the same day. The tenant and the landlord both have a 31 March balance date.

The tenant

Under section CC 1B, $100,000 is taxable to the tenant. Under section EI 4B, the income is spread evenly over the 10-year period from the 2013–14 to the 2022–23 income years inclusive (i.e. $10,000 income is allocated to the tenant in each income year).

The landlord

Under section DB 20B, $100,000 is deductible for the landlord. Under section EI 4B, the deductions are spread evenly over the 10-year period from the 2013–14 to the 2022–23 income years inclusive (i.e. a deduction of $10,000 is allocated to the landlord in each income year).

An amount incurred or derived part-way through the spreading period is spread over the remainder

The allocation of income and deductions for lease inducement payments is affected by when the income or expenditure is derived or incurred in relation to the spreading period. For example, if the amount is derived or incurred half-way through the spreading period, the amount is spread evenly over the remaining spreading period. If the amount is derived or incurred at or after the end of the spreading period, the amount is allocated to the income year in which it is incurred or derived.

The maximum spreading period is 50 years

If the spreading period is more than 50 years, the amount is allocated evenly over the first 50 income years (section EI 4B(3)(a)(iii)).

[*Tax Information Bulletin* Vol. 25 No. 9 October 2013 page 28 -29].

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(3) THE SPREADING RULE FOR LEASE INDUCEMENT PAYMENTS (continued)

3. TIB explanation of the spreading rule (continued)

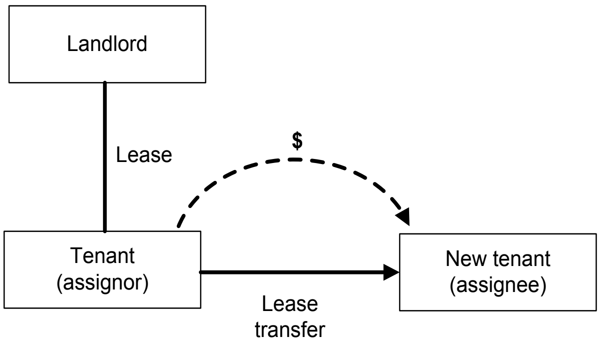
Payment by assignor is not spread whereas receipt by assignee is spread

Note that, under the timing provision, an amount of expenditure incurred by an assignor to induce an assignee to receive an assignment of a lease is allocated to the income year in which the amount is incurred. By assigning the lease, the assignor has no remaining period over which to spread the expenditure. On the other hand, the assignee spreads the amount of income evenly over the remaining period of the lease.

Example

On 1 April 2014, a tenant enters into a 10-year lease. However, after three years, the tenant finds that their business is not doing well and finds the lease burdensome.

The tenant becomes aware that A Ltd is looking for premises. The tenant is keen for A Ltd to take the lease. On 1 October 2017, the tenant pays $30,000 to A Ltd to transfer the lease from that date.



The timing of income and deductions for the tenant and A Ltd under section EI 4B is illustrated in the table below. The tenant and A Ltd have a 31 March balance date.

Income year	The tenant (assignor)		A Ltd (assignee)	
	Deduction	Income	Deduction	Income
2014–15	–	–	–	–
2015–16	–	–	–	–
2016–17	–	–	–	–
2017–18	$30,000	–	–	$2,308
2018–19	–	–	–	$4,615
2019–20	–	–	–	$4,615
2020–21	–	–	–	$4,615
2021–22	–	–	–	$4,615
2022–23	–	–	–	$4,615
2023–24	–	–	–	$4,615

[*Tax Information Bulletin* Vol. 25 No. 9 October 2013 page 29].

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(3) THE SPREADING RULE FOR LEASE INDUCEMENT PAYMENTS (continued)

3. TIB explanation of the spreading rule (continued)

Application of the timing provision to a contribution towards the cost of a fit-out

The timing provision does not apply to an amount that is treated as income under section CC 1 or CG 8, which relate to income from land or capital contributions respectively. Income under section CC 1 is taxable when derived unless the timing rule in section EI 7 applies. Income under section CG 8 is spread evenly over 10 years unless the payee chooses to reduce the cost base of the depreciable property under section DB 64.

The following example explains how the timing provision would apply to a contribution towards the cost of a fit-out.

Example

On 1 April 2013, a tenant receives a lease inducement payment of $100,000 from its landlord to enter into a 12-year lease. The terms and conditions of the agreement require that the tenant must use the payment for a fit-out of their lease premises.

The tenant spends a total of $300,000 on its fit-out in the 2013–14 income year. The tenant and the landlord both have a 31 March balance date.

The tenant

The tenant can either choose to return $100,000 as income over the next 10 years, starting from the 2013–14 income year, or reduce the cost base of the fit-out by $100,000. Under the latter option, the tenant is only able to claim depreciation on the remaining $200,000 of expenditure incurred on the fit-out.

The landlord

The landlord is allowed a deduction of $100,000 under section DB 20B, which is allocated under section EI 4B over the 12-year period from the 2013–14 to the 2024–25 income years inclusive (i.e. a deduction of $8,333 is allocated to the landlord in each income year).

[*Tax Information Bulletin* Vol. 25 No. 9 October 2013 page 30].

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(3) THE SPREADING RULE FOR LEASE INDUCEMENT PAYMENTS (continued)

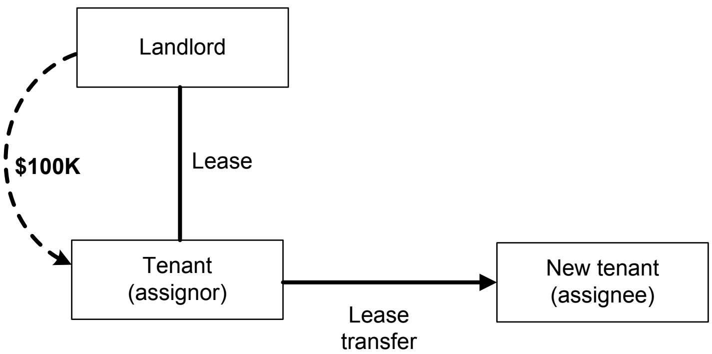
3. TIB explanation of the spreading rule (continued)

Disposal of the land right part-way through the spreading period

An exception applies to the new timing rule if the person ceases to hold the relevant land right or the estate in land from which the land right is granted. Generally, a "wash-up" calculation of income and deductions is allowed if a person ceases to hold the land right or the estate in land from which the land right is granted, part-way through the spreading period (section EI 4B(4) and (5)). For income, if there is a remaining amount to be allocated under the main spreading provision in section EI 4B(3), the amount of income is allocated to an income year (the balance year) ending before the end of the spreading period, if –

- At the beginning of the balance year, the person holds the land right or the estate in land from which the land right is granted; and
- In the balance year, the person ceases to hold the land right or the estate in land from which the land right is granted (section EI 4B(4)).

Example: On 1 April 2013, a landlord pays a tenant $100,000 as an inducement to enter into a 10-year lease. On 1 June 2016, the tenant transfers the lease to a new tenant. Both the landlord and the tenant have a balance date of 31 March. The $100,000 payment is taxable to the tenant under section CC 1B and deductible to the landlord under section DB 20B.



The timing of income for the tenant under section EI 4B(4) is illustrated in the table below:

Income year	**Tenant**	
	Deduction	Income
2013–14	–	$10,000
2014–15	–	$10,000
2015–16	–	$10,000
2016–17	–	$70,000
2017–18	–	–
2018–19	–	–
2019–20	–	–
2020–21	–	–
2021–22	–	–
2022–23	–	–

The landlord continues to allocate the $100,000 deduction under the main spreading provision in section EI 4B(3).

[*Tax Information Bulletin* Vol. 25 No. 9 October 2013 page 30].

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(3) THE SPREADING RULE FOR LEASE INDUCEMENT PAYMENTS (continued)

3. TIB explanation of the spreading rule

Associated persons rule for disposals part-way through the spreading period

For deductions, if there is a remaining amount to be allocated under the main spreading provision in section EI 4B(3), the amount of deductions is allocated to an income year (the balance year) ending before the end of the spreading period if –

- At the beginning of the balance year, either or both the land right and the estate in land from which the land right is granted are held by the person or an associated person; and
- At the end of the balance year, neither of the land right and the estate in land from which the land right is granted are held by the person or an associated person (section EI 4B(5)).

Note that if the land right or the estate in land from which the land right is granted is transferred to an associated person, no "wash-up" calculation for deductions is allowed. The remaining amount of deductions continues to be allocated over the spreading period under section EI 4B(3). This is intended as an anti-avoidance measure to prevent the timing of deductions being accelerated by transferring the land right or the estate in land from which the land right is granted to an associated person.

The definition of "land provision" in section YA 1 has been amended so that the definition of "associated person" applying in section EI 4B is the one applicable to land provisions.

To prevent overlap, section EA 3, which relates to the timing of prepayments, has been amended to exclude any amounts subject to this timing provision.

[*Tax Information Bulletin* Vol. 25 No. 9 October 2013 pages 30-31].

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

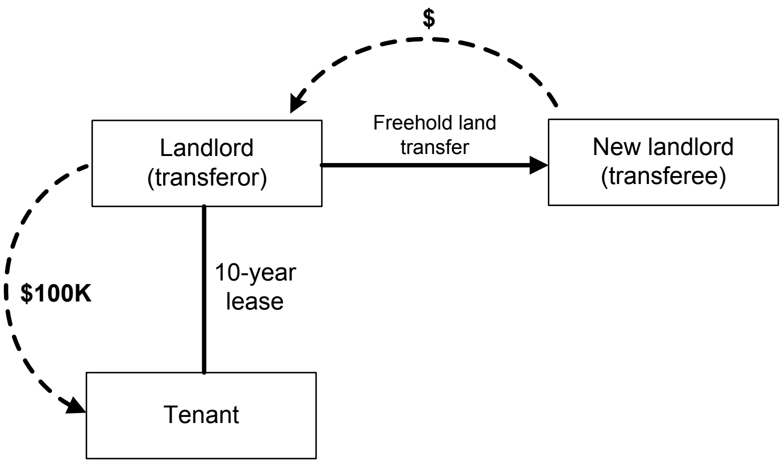
(3) THE SPREADING RULE FOR LEASE INDUCEMENT PAYMENTS (continued)

3. TIB explanation of the spreading rule

Associated persons rule for disposals part-way through the spreading period (continued)

Example

On 1 April 2013, a landlord pays a tenant $100,000 as an inducement to enter a 10-year lease. On 6 June 2016, the landlord sells the freehold land to an unassociated third party. Both the landlord and the tenant have a balance date of 31 March.



The $100,000 payment is taxable to the tenant under section CC 1B and deductible to the landlord under section DB 20B.

The timing of deductions for the landlord under section EI 4B(5) is illustrated in the table below:

Income year	Landlord	
	Deduction	Income
2013–14	$10,000	–
2014–15	$10,000	–
2015–16	$10,000	–
2016–17	$70,000	–
2017–18	–	–
2018–19	–	–
2019–20	–	–
2020–21	–	–
2021–22	–	–
2022–23	–	–

If the landlord had transferred the land to their spouse, the landlord would continue to allocate $10,000 of deductions to each income year until the 2022–23 income year.

The tenant continues to allocate the $100,000 amount of income under the main spreading provision in section EI 4B(3).

[*Tax Information Bulletin* Vol. 25 No. 9 October 2013 page 31].

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(4) CONSEQUENTIAL CHANGES RELATING TO THE SPREADING RULES

1. General rules in s. EA 3 for unexpired expenditure do not apply

The general rules in s. EA 3 for unexpired expenditure will not apply to a leasehold estate or licence to use land to which the spreading rules in s. EI 4B will apply.

[**s. EA 3(2)(db)** as inserted by **s. 38** of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013* coming into force on 1 April 2013].

2. The spreading rules in s. EI 4B are treated as part of the 'land provisions'

The definition of "land provisions" has been amended so that the spreading rules in s. EI 4B form part of the land provisions as defined in s. YA 1.

This is apparently to ensure that the meaning of 'associated person' for the purposes of the spreading rules in s. EI 4B is the meaning that applies to the land provisions.

[Amendment to the definition of **land provisions** in **s. YA 1** contained in **s. 98(22)** of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013* coming into force on 1 April 2013].

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(5) PERMANENT EASEMENTS

Exclusion of payments for permanent easements other than periodic payments

A new s. CC 1(2C) has been inserted that states:

An amount is not income of the owner of a fee simple estate in land if the amount is derived as consideration for the grant, for the duration of the estate, of an easement over the land and is not a periodic payment.

This rule applies from 1 April 2015.

A payment for a permanent easement is taxable to a landowner under s. CC 1 until 1 April 2015.

Officials have stated in the *Commentary* that:

"The purpose of this specific exclusion is to align the tax treatment of a permanent easement (or a perpetual right of way) with that for freehold land under the existing s. CC 1."

The Bill initially excluded all payments for permanent easements from being taxable to landowners. Officials were of the view that it should be clarified that the exclusion does not apply to ongoing periodical payments for a permanent easement, as such payments should be on revenue account. The enacted s. CC 1(2C) reflects that.

Officials have pointed out that the land provisions in ss. CB 6 to CB 23B will continue to apply to permanent easements.

A payment for a permanent easement will continue to be non-deductible to the payer. Currently, a payment for a permanent easement is non-deductible under the depreciation rules because a permanent easement does not meet the definition of depreciable property under s. EE 6. In normal circumstances, it is not reasonably expected to decline in value. This treatment will not change.

[**s. CC 1(2C)** as inserted by **s. 9** of the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014* coming into force on 1 April 2015; *Commentary* to the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill* page 87; *Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill* page 198].

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(6) GLASGOW LEASES

Perpetually renewable leases will not be depreciable property from 1 April 2015

Section EE 7 lists property that is not depreciable property. Land is excluded from being depreciable property under s. EE 7(a).

A new s. EE 7(ab) has been inserted, with effect from 1 April 2015, under which a lease of land with a perpetual right of renewal will not be depreciable property. The effect will be to treat a perpetually renewable lease similarly to freehold land for tax depreciation purposes.

A perpetually renewable lease is explained as follows in the *Commentary*:

"Perpetually renewable leases last for a certain duration (for example, 7, 10 or 21 years), but are renewable in perpetuity at the option of tenants. They are commonly known as "Glasgow" leases. They are typically for the bare land only and tenants generally own the improvements on the land. Rents on these leases are reviewed periodically (usually to a market rate). "

Under current rules, such a lease is not excluded from being depreciable property and lease payments could be depreciable and/or a loss on disposal may be claimable, if the requirements for depreciable property are met:

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

(b) It is property that, in normal circumstances, might reasonably be expected to decline in value while it is used or available for use in deriving assessable income or in carrying on a business for the purpose of deriving assessable income; and

(c) It is not listed in s. EE 7.

In most cases, a depreciation deduction may not be available over the term of the lease because of the perpetually renewable period, but a loss on disposal could be claimed under the current rules if the lease is sold for less than its adjusted tax value.

The amendment will mean that no loss on disposal can be claimed under the depreciation rules when a perpetually renewable lease is sold.

The recipient of a payment for a perpetually renewable lease will continue to be taxed under s. CC 1. Officials noted that such a payment (for example, a lease premium) is easily substitutable for taxable rent payments on a perpetually renewable lease that are periodically reset to market levels.

[**s. EE 7(ab)** as inserted by **s. 65** of the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014* coming into force on 1 April 2015; *Commentary* to the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill* page 88].

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(7) CONSECUTIVE LEASES

The term of a lease will include the term of consecutive leases from 1 April 2015

A new paragraph (d) extending the definition of "legal life" in s. EE 67 has been inserted that states:

For a person and a right (a **land right**) that is a leasehold estate, or a licence to use land, (legal life) means the number of years, months, and days for which the person or an associated person (as defined for the land provisions) has an owner's interest in the land right, or in a consecutive or successive land right, under the contract or statute that creates the owner's interest, determined:

(i) When the person acquires the owner's interest; and

(ii) Assuming that the person or associated person exercises rights of renewal, extension, or further grant that are either essentially unconditional or conditional on the payment of predetermined fees.

This applies from 1 April 2015. Officials referred to it as a specific additional anti-avoidance measure.

The effect of the amendment will be that:

(a) For consecutive leases over the same parcel of land, that are granted to a person or an associated person (as defined for the land provisions) at the same time, the term of a lease will include the terms of consecutive leases owned by the person or the associate; but

(b) Consecutive leases would need to be acquired by the person or associated person at the same time to be counted towards the legal life of a lease; and

(c) Any genuinely subsequently negotiated leases or licences of land will not be counted towards the legal life of a lease.

Example

On 1 April 2015, A Ltd and its associates, B Ltd and C Ltd, enter into three separate leases for the same parcel of land to take effect immediately after one terminates. The first lease commences on 1 April 2015. Each lease lasts for 10 years.

Lease	Commencement date	Lease ownership	Term of the lease
1	1 April 2015	A Ltd	10 years
2	1 April 2025	B Ltd	10 years
3	1 April 2035	C Ltd	10 years

A Ltd, B Ltd and C Ltd are associated and they have entered into consecutive leases for the same parcel of land on the same day. Therefore, under the proposed rules:

- A Ltd's interest (owner's interest) in the lease will be treated as lasting for 30 years, which includes both B Ltd and C Ltd's interests in the lease.
- B Ltd's interest (owner's interest) in the lease will be treated as lasting for 20 years, which includes C Ltd's interest in the lease.
- C Ltd's interest (owner's interest) in the lease lasts for 10 years as there is no consecutive lease.

[Amendment to the definition of "legal life" in **s. EE 67** inserted by **s. 68** of the *Taxation (Annual rates, Employee Allowances, and Remedial Matters) Act 2014* coming into force on 1 April 2015; *Commentary* to the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill* page 88-89].

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(8) RETIREMENT VILLAGE OCCUPATION RIGHTS

Retirement village occupation rights are an excepted financial arrangement from 1 April 2015

1. A new paragraph (f)(iii) has been inserted into the definition of "lease" in s. YA 1 which states:

   (f) A lease in the financial arrangements rules, means- …

   (iii) An occupation right agreement as defined in the Retirement Villages Act 2003.

   This amendment comes into force on 1 April 2015.

2. Retirement village occupation rights that are licences to occupy are currently regarded as financial arrangements because they are not a lease for the purposes of financial arrangement rules as defined in s. YA 1.

3. Officials have stated in the *Commentary* that:

   "Treating certain retirement village occupation rights as financial arrangements is undesirable from a policy perspective. In particular, if certain retirement village occupation rights are subject to the financial arrangement rules, there may be tax consequences for a retirement village resident.

   The existing financial arrangement rules shift financial benefits from the transaction from one party to another. Consequently, under certain retirement village occupation rights arrangements, deductions may be allowed to a retirement village operator and assessable income may arise to the resident. This tax outcome would not generally have been contemplated by the contracting parties at the time of the transaction."

4. The amendment to paragraph (f) of the "lease" definition in s. YA 1 will mean that retirement village occupation rights will be treated as an excepted financial arrangement in s. EW 5(9), and excluded from the financial arrangement rules.

5. It is noted in the *Commentary* that Determination S16, which was issued by the Commissioner of Inland Revenue in 2010, applies to certain retirement village occupation rights that are leases resulting in the financial arrangement rules not applying to such arrangements. However, officials prefer a legislative amendment to "provide greater certainty and ensure that all occupation right agreements under the *Retirement Villages Act 2003* are excluded from the financial arrangement rules".

[Amendment to the definition of "lease" in **s. YA 1** inserted by **s. 144(26)** of the *Taxation (Annual rates, Employee Allowances, and Remedial Matters) Act 2014* coming into force on 1 April 2015; *Commentary* to the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill* page 91].

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(9) LEASE INCOME DERIVED IN ANTICIPATION

Amendments to spreading provisions in s. EI 7

1. Section EI 7 applies when a person derives, in a tax year, income in anticipation from fines, premiums, a payment of goodwill on the grant of a lease, or in another similar way. Relief is provided to the taxpayer, who is allowed spread the income over 6 years.
2. Prior to enactment of self-assessment legislation, taxpayers followed the Commissioner's practice and spread the income evenly over the years. Following the enactment of self-assessment, it became arguable that income did not have to be spread on an even basis.
3. From the 2015-16 income year, s. EI 7(2) is being replaced so as to allow a person to choose to:
   (a) Divide the income into 6 equal portions; and
   (b) Allocate a portion to the income year in which they derive the amount; and
   (c) Similarly allocate a portion to each of the next 5 income years."
4. Taxpayers will make the election themselves, and will no longer have to request the Commissioner to make the allocation.
5. A transitional provision has been inserted as s. EI 7(5) which will apply when a person has derived an amount of income to which this section applies before the 2015–16 income year, and all or part of that amount remains unallocated at the start of that income year. The person must:
   (a) If the period of 5 income years after the income year of derivation has expired by the start of the 2015–16 income year, allocate the remaining amount to the 2015–16 income year; or
   (b) If the period of 5 income years after the income year of derivation has not expired before the start of the 2015–16 income year, divide the remaining amount into equal portions based on the number of income years left in the period, and allocate a portion to each of those income years falling after the end of the 2014–15 income year.

Example 1: Transitional effect

The taxpayer has chosen to spread the income derived in the 2011–12 income year from land for payments in the nature of fines, premiums or goodwill on the grant of a lease on an even basis. The policy intention is that this would result in all of that income being allocated evenly over the 2011–12 to 2016–17 income years.

The transitional rule provides that the amount of income derived in the 2011–12 income year that remains unallocated at the start of the 2015–16 income year is spread evenly over the 2015–16 and 2016–17 income years.

[**s. EI 7** as amended by **s. 71** of the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014* applying to the 2015-16 and later income years; *Commentary* to the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill* pages 159-161].

LEASE INDUCEMENT, LEASE SURRENDER AND LEASE TRANSFER PAYMENTS

(10) DISPOSAL OF LAND TO THE CROWN

Amendments to spreading provisions in s. EI 8

1. Section EI 8 applies when a person derives income from disposing of any of their land to the Crown. The person is allowed to spread the income over 4 years.

2. Prior to enactment of self-assessment legislation, taxpayers followed the Commissioner's practice and spread the income evenly over the years. Following the enactment of self-assessment, it became arguable that income did not have to be spread on an even basis.

3. From the 2015-16 income year, s. EI 8(2) is being replaced so as to allow a person to choose to:
   (a) Divide the income into 4 equal portions; and
   (b) Allocate a portion to the income year in which they derive the amount; and
   (c) Similarly allocate a portion to each of the next 3 income years."

4. A transitional provision has been inserted as s. EI 8(6) which will apply when a person has derived an amount of income to which this section applies before the 2015–16 income year, and all or part of that amount remains unallocated at the start of that income year. The person must:

   (a) If the period of 3 income years after the income year of derivation has expired by the start of the 2015–16 income year, allocate the remaining amount to the 2015–16 income year; or

   (b) If the period of 3 income years after the income year of derivation has not expired before the start of the 2015–16 income year, divide the remaining amount into equal portions based on the number of income years left in the period, and allocate a portion to each of those income years falling after the end of the 2014–15 income year.

[**s. EI 8** as amended by **s. 72** of the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014* applying to the 2015-16 and later income years; *Commentary* to the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill* pages 159-161].