



WEEKLY COMMENT: FRIDAY 22 MARCH 2013

1. New proposals affecting lease inducement payments and lease surrender payments were released on 11 December 2012 in *Supplementary Order Paper No. 167* (“the SOP”) to the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Bill* (“the Bill”). The Bill is due to be reported from the Finance and Expenditure Committee on 29 May 2013.
2. The new rules affecting lease inducements and lease surrenders are proposed to come into force on 1 April 2013, although the legislation will not have been enacted by that date. The new laws will apply, generally, to an amount that is derived or incurred from 1 April 2013. The new rules will not apply, and the pre-existing general principles and provisions of the *Income Tax Act 2007* will apply to amounts derived or incurred that relate to:
 - (a) Agreements to lease land entered into before 1 April 2013; or
 - (b) Licences to use land provided before 1 April 2013.
3. An “amount” is generally defined in s. YA 1 as “includes an amount in money’s worth”. (It is also specifically defined for the purposes of various specific provisions.) Therefore the rules will apply to non-cash consideration.

Income from lease inducements

4. Consideration derived by a person (“the payee”) for agreeing to the grant, renewal, extension or transfer of a land right that is a leasehold estate or a licence to use land will be income of the payee, under new s. CC 1B. There are specified exceptions:
 - (a) The rules will not apply to a land right that is not a leasehold estate or a licence to use land. “Leasehold estate” is defined in s. YA 1 as “includes any estate, however created, other than a freehold estate”. Therefore the rules will not apply to consideration from the grant or transfer of a freehold estate.
 - (b) The rules will not apply to an amount derived by the holder of the land right as consideration for the transfer of the land right to the payer of the consideration. Therefore, for example, the rules will not apply to an amount paid by an assignee to an assignor for the transfer of an existing lease.
 - (c) The rules will not apply to an amount derived by a payee as a tenant of residential premises. But this is not a complete exception: if there is concurrent use of the land right for residential and business purposes, the amount will be apportioned and only the amount relating to residential use will not be subject to the rules.
5. Consideration received for *agreeing* to the transfer of a land right is worth a special mention. The rules capture such amounts. However, consideration received for the *actual transfer* of

the land right is not subject to these rules. Therefore, an amount paid by an assignor to get the assignee to agree to the transfer will be caught by the rules, but not an amount paid by the assignee to the assignor for the actual transfer.

6. It is noted on page 26 of the *Commentary on Supplementary Order Paper No. 167* (“the Commentary”) that:

“This reform is limited in scope by addressing existing tax asymmetries relating only to lease inducement payments and lease surrender payments. However, there are other existing tax asymmetries in the tax system in relation to other land-related lease payments such as lease transfer payments. Currently, lease transfer payments are generally non-taxable to the commercial tenant recipient and deductible to the incoming commercial tenant under the depreciation rules.

Following the limited reforms included in this Supplementary Order Paper, there will be a further review of the taxation of other commercial lease-related payments. The objective of the review is to provide a consistent and coherent tax treatment of all commercial land-related lease payments that is consistent with the broad base, low-rate tax framework. It is expected that an officials’ issues paper will be released for public consultation early next year (i.e. 2013) seeking feedback on the review.”

Deductions for lease inducements

7. The deduction rules in new s. DB 20B match the income provisions. A payer will get a deduction if the payment is for an *agreement by the payee* to the grant, renewal, extension, or transfer of a land right that is a leasehold estate, or a licence to use land, and:
- (a) The payer is the person who owns the land right or the estate in land from which the land right is granted; and
 - (b) The payee is the person who is obtaining the land right.

8. It is stated on page 28 of the Commentary that:

“Note that this deduction provision will cover other lease inducements, in particular, contribution for fit-out costs. A consequence of this is that the timing rule for deductions in new section EI 4B (discussed below) will apply to such other lease inducements.”

The spreading of lease inducement income and deductions

9. There is a timing provision, new s. EI 4B, which is intended to allocate income and deductions from lease inducements to income years over the term of the lease.
10. The spreading provision contemplates termination or expiry of a land right and consequently relates to a period beginning with the commencement of the land right or the most recent renewal or extension, and ending with termination or expiry. However, if the spreading period exceeds 50 years, the spreading period is treated as 50 years – i.e. the spreading period cannot exceed 50 years.
11. The spreading commences at the time an amount is derived or incurred: this can be at any time in the lease period. The amount is spread over the income year in which it is derived or incurred and over the remaining income years in the spreading period. If the amount is derived or incurred after the end of the spreading period, it is allocated to the income year in which it is derived or incurred.

12. If a recipient of a lease inducement ceases to hold the relevant land right before the spreading period has ended, the remaining unallocated amount is allocated to the income year in which the person held the land right at the beginning, but not at the end.
13. Similarly, if a payer (including any person associated with the payer) of a lease inducement ceases to hold both a land right and the estate in land from which the land right is granted before the spreading period has ended, the remaining deduction may be taken in the year that happens. Note, however, that both the land right and the estate in land from which the land right is granted must be relinquished. This will mean that if a lessee terminates a lease early, the lessor will have to continue to spread the deductions for a lease inducement paid earlier, unless the lessor also ceases to hold the estate in the relevant land.
14. The Commentary, on page 29, draws particular attention to the circumstances where an assignor induces an assignee to receive an assignment of a lease:
- “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 would be 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 would spread the amount of income evenly over the remaining period of the lease.”
15. A transfer to an associated person will not be considered to be a cessation for the purposes of the spreading rules, as noted in paragraph 13 above. The following is stated on page 31 of the Commentary:
- “Note that if the land right or the estate in land from which the land right is granted is transferred to an associated person, there will be no “wash-up” calculation for deductions. The remaining amount of the deductions will continue 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 general anti-avoidance provision in section BG 1 will also apply to counter any tax-driven transactions that attempt to exploit the new timing provisions contrary to the policy intent.
- The definition of “land provision” in section YA 1 is being amended so that the definition of “associated person” applying in section EI 4B is the version applicable to land provisions.”
16. The general rules, in s. EA 3, that apply to unexpired expenditure will not apply to expenditure subject to the special timing rules in s. EI 4B.

Income from lease surrender payments

17. A payee will be taxable, under new s. CC 1C, on an amount derived from a payer if:
- (a) The payment is for an *agreement by the payee* to the surrender of a leasehold estate, or the termination of a licence to use land; and
 - (b) The payee is the person who owns the land right or the estate in land from which the land right is granted.
18. This rule can apply regardless of whether the surrender payment is made by a landlord or a tenant.
19. This rule will not apply to an amount derived by a payee as a tenant of residential premises. However, this is not a complete exception: if there is concurrent use of the land right for

residential and business purposes, the amount will be apportioned and only the amount relating to residential use will not be subject to this taxing rule.

Deductions for lease surrender payments

20. The deduction rules in new s. DB 20C match the income provisions. A payer will get a deduction if the payment is for an *agreement by the payee* to the surrender of a leasehold estate, or the termination of a licence to use land, and:

(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 land right or the estate in land from which the land right is granted.

No timing provision for lease surrender payments

21. There is no specific timing provision for lease surrender payments. The timing of income or expenditure in relation to lease surrender payments will, therefore, be determined under the general provisions of the Act.

22. It is stated on page 33 of the Commentary that:

“Generally, income and deductions for lease surrender payments will be allocated to the income year in which the amount is derived or incurred.”

23. For those of you who are interested, the proposed new legislation is described in the attached PDF on *Lease Inducement and Lease Surrender Payments*.



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