KPMG
10 Customhouse Quay
PO Box 996
Wellington 6140
New Zealand
T: +64 4 816 4500

Our ref: 161201KPMGsubDSAv2

Team Manager
Technical Services
Office of the Chief Tax Counsel
Inland Revenue
P O Box 2198

1 December 2016

Dear Sir or Madam

KPMG submission on revised QWBA - Deductibility of the Costs of Obtaining a Detailed Seismic Assessment of a Building

We welcome the opportunity to make a submission on the revised draft Question We've Been Asked ("QWBA") item on the deductibility of Detailed Seismic Assessment ("DSA") costs.

General comments

We commend the Commissioner for recognising the concerns raised by KPMG (and others) on her original December 2015 draft. That concluded that a DSA, regardless of the context, was directed to the further preservation or otherwise of a capital asset (the building). It was not part of the day-to-day operations. The relevant costs were on capital account.

We are pleased the Commissioner has recognised situations where the need or occasion for a DSA is a taxpayer's ordinary business operations. These include satisfying potential tenants of a building's safety, procuring insurance or funding, or satisfying a legal requirement imposed by Council. It has concluded that these costs are likely to be on revenue account. We strongly support this analysis and conclusion. It is consistent with the commercial drivers of DSAs.

Detailed comments

Our original submission raised the question of the deductibility of initial seismic assessment costs. (The earlier draft QWBA concluded non-deductibility for expenditure on DSAs, but left silent the treatment of initial seismic survey expenditure.) On the basis of the revised conclusion, and applying the principles of the recent *Trustpower* Supreme Court decision, we consider that initial seismic assessment costs will also be on revenue account. It would be useful for the Commissioner's position on these costs to be confirmed in her finalised QWBA.

In our submission on *PUB00278 – Deductibility of Feasibility Expenditure* we raised concerns regarding the draft QWBA's statement that the *"principles from Trustpower do not assist in determining the deductibility of the costs incurred in the situations identified in this item"*.

This statement may have been made because the original draft QWBA attempted to distinguish the feasibility expenditure interpretation statement on the basis that previous IS 08/02 applied to the creation of new, not existing assets. PUB00278 does not appear to have any such distinction as a capital project can be for new or existing assets. This reason for distinguishing the feasibility expenditure interpretation statement therefore no longer applies.

The Commissioner has seemingly drawn a distinction between the capital vs. revenue analysis applied by the Supreme Court in *Trustpower* and her analysis of the deductibility of DSA costs. As a matter of principle, we would expect the Supreme Court's approach in *Trustpower* to be relevant. It is New Zealand's highest and most recent authority on the general permission and the capital vs. revenue distinction. Although *Trustpower's* effect may be unclear, it seems unrealistic to us to suggest that it will have no weight. Therefore, we are not convinced it can be so easily dismissed in the QWBA.

This is not to suggest that the Commissioner's revised approach in relation to DSA costs is incorrect. We believe the approach adopted is commercial. It is supported by the weighing up of the various factors identified in *BP Australia* for the different fact scenarios. (See also our earlier submission on DSA costs.) Our recommendation is that the Commissioner attempt, as best as possible, to apply the relevant parts of the *Trustpower* decision to her approach to DSA costs.

Paragraph 37 of the draft QWBA states that DSA costs are likely to be on capital account *"where they are incurred as part of either a capital project to seismically strengthen a building or a capital project to develop or improve a building"*. We make two comments here:

— The treatment of DSA costs incurred when acquiring a building should be explicitly stated. We assume that such costs would generally be on capital account. This applies the draft QWBA and the draft feasibility expenditure interpretation statement (i.e. the "project", the building, is clearly identified and the DSA would "materially advance" its acquisition). (Obviously, revenue account taxpayers would not have capital treatment for DSA costs.)

— Relatedly, the finalised QWBA should confirm that a capital outcome arises only where a DSA is part of a capital project. For example, where a routine DSA analysis reveals seismic issues that result in the need to strengthen a building, the DSA costs should still be deductible. From a business/practical point of view, the driver is not the need to undertake capital works. Explicitly stating this principle would be helpful in avoiding any future disputes with Inland Revenue on how the QWBA is intended to be applied.

We believe some examples in the finalised QWBA would be useful in drawing out the points above.

Further information

Please do not hesitate to contact us, John Cantin on (04) 816 4518 or Darshana Elwela on (09) 367 5940, if you would like to discuss our submission in greater detail.

Yours sincerely

John Cantin
Partner

Darshana Elwela
National Tax Director