



MIXED-USE ASSETS: INCOME TAX IMPLICATIONS

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SECTION I: WHICH ASSETS THE RULES APPLY TO

<p>(1) What the policy objective underlying the new rules is</p>	<p>(1) Policy objective of the mixed-use assets rules</p> <p>The policy objective of the mixed-use assets rules is to better align deductions that are claimed with the taxable income that is earned. This is achieved by limiting the deductions that can be claimed for periods when the asset is not in use.</p> <p>[Page 22, <i>Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill</i>, March 2013]</p> <p>The FBT and the deemed dividend rules work well where the shareholder or an associate uses an asset owned by the company, but <i>they do not deal with the time an asset is not used but available for use</i>. As a general principle, the policy objective of the proposals of matching deductions to income earning use is therefore more likely to be achieved by the mixed-use asset rules applying rather than the FBT or deemed dividend rules. (emphasis added)</p> <p>[Page 23, <i>Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill</i>, March 2013]</p>
<p>(2) The rules will not apply to companies other than close companies</p>	<p>(2) The rules exclude companies other than close companies</p> <ol style="list-style-type: none"> 1. The rules will not apply to a company that is not a close company. A "close company" means, at any time, a company in which: <ol style="list-style-type: none"> (a) At the time there are 5 or fewer natural persons the total of whose voting interests in the company is more than 50% (treating all natural persons associated at the time as 1 natural person); or (b) At the time a market value circumstance exists for the company and there are 5 or fewer natural persons the total of whose market value interests in the company is more than 50% (treating all natural persons associated at the time as 1 natural person). 2. Officials clarified that the rules will apply to a subsidiary company only if the parent company is also a close company. 3. For the purposes of the mixed-use assets rules, a trustee is treated as a natural person when determining if a company is a close company and subject to the rules. 4. A special corporate entity is specifically excluded from being a close company: such an entity is defined as meaning: a Crown Research Institute, a group investment fund, a life insurance fund, an entity that has not issued shares and is engaged mainly in the business of providing life insurance or other insurance to the public, a local authority, a public authority, a State enterprise, a statutory producer board other than a body that derives only exempt income, any other statutory body that does not issue shares, if established under an Act of Parliament and the Commissioner decides it should be treated as a special corporate entity, and any body incorporated under the <i>Incorporated Societies Act 1908</i> which has no shares on issue at any time in the income year. <p>[Section DG 3(3) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets</i></p>

Expenditure, and Remedial Matters) Act 2013 & s. YA 1 definition of close company and page 35 of the Officials' Report to the Finance and Expenditure Committee]

SECTION I: WHICH ASSETS THE RULES APPLY TO (continued)

<p>(3) Which assets the rules apply to</p>	<p>(3) Which assets the rules apply to</p> <ol style="list-style-type: none"> 1. The rules apply on an asset-by-asset basis. 2. For income tax purposes, the rules must be <u>applied in relation to each income year</u>. 3. There are 3 requirements for the rules to apply to expenditure incurred in relation to an asset in an income year: <ol style="list-style-type: none"> (a) The asset must be <i>used</i> by the person in the income year partly to derive income; and (b) The asset must be <i>used</i> by the person in the income year partly for <i>private use</i>; and (c) For a time during the income year, the asset must <i>not be in use</i>, that time being: <ol style="list-style-type: none"> (i) For at least 62 days in the income year; or (ii) When the asset is typically used only on working days, for at least 62 working days in the income year. 4. There are 3 types of asset that the rules apply to: they are, <i>in the complete form in which the person uses them</i> for income-earning purposes, and <i>including any related items, things or accessories pertaining to the asset</i>: <ol style="list-style-type: none"> (a) Land, including improvements to land; (b) A ship, boat, or craft used in navigation on or under water, whether or not it has a means of propulsion that: <ol style="list-style-type: none"> (i) Cost the person \$50,000 or more; or (ii) Had a <i>market value</i> on the date of acquisition of \$50,000 or more, if the asset was not acquired at market value. (c) An aircraft that: <ol style="list-style-type: none"> (i) Cost the person \$50,000 or more; or (ii) Had a <i>market value</i> on the date of acquisition of \$50,000 or more, if the asset was not acquired at market value. 5. The concepts of "ships, boats or craft" and "aircraft" are not defined. They are intended to have a broad ordinary meaning. 6. In the case of all three categories of assets, for the purposes of these rules, the asset will include any assets which are related to it. So, in the context of a holiday home, items such as the furniture and appliances will be subject to the rules, and in the context of a yacht, items such as the dinghy and lifejackets will be included. <p>[Sections DG 1 and DG 3(1) & (2) as inserted by s. 30(1) of the Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013 and Inland Revenue</p>
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	Policy and Strategy Special Report 14 August 2013 <i>Mixed-use assets</i> page 4.]
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SECTION I: WHICH ASSETS THE RULES APPLY TO (continued)

<p>(4) Entities subject to the rules</p>	<p>(4) Entities subject to the rules</p> <ol style="list-style-type: none"> 1. The rules apply to any person claiming deductions in relation to the asset, not just the person who owns it. For example, a person who leases an aircraft, and then uses it personally and rents it out, will be subject to the rules. 2. The rules apply to deductions claimed in all entities other than companies that are not close companies (i.e. the rules do not apply to assets held by companies known as widely held). <p>[Inland Revenue Policy and Strategy Special Report 14 August 2013 <i>Mixed-use assets</i> page 4.]</p>
<p>(5) Meaning of market value</p>	<p>(5) Meaning of market value</p> <p>Market value follows the definition for FBT in s. RD 40(2) and means the price at which the asset is provided for use at a particular time or for a particular season:</p> <ol style="list-style-type: none"> (a) In the open market; and (b) Freely offered; and (c) Made on ordinary terms; and (d) To a member of the public at arm's length. <p>[Section DG 3(5) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i> & s. RD 40(2)]</p>
<p>(6) Aggregation of assets treated as a single asset</p>	<p>(6) The definition aggregates assets that should be treated as a single asset</p> <ol style="list-style-type: none"> 1. Note that the references to “the complete form in which the person uses it” and “includes any related items” etc. have been inserted to allay concerns that a power boat, for example, could be separately treated as a motor and a hull. 2. Officials were also concerned to ensure that assets should not fall below \$50,000 because their cost was reduced under some other provision in the Act. 3. If the asset is held through a partnership or LTC, the values of the interests of all the partners or shareholders in the LTC are aggregated. 4. When an asset is leased on a long-term basis, the \$50,000 threshold applies to the market value of the asset when the person first leased it. <p>[Section DG 3(2) & (6) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i> and the <i>Officials’ Report to the Finance and Expenditure Committee on Submissions on the Bill</i>, pages 41 and 42.]</p>

SECTION I: WHICH ASSETS THE RULES APPLY TO (continued)

(7) Excluded assets**(7) The following are excluded assets to which the rules do not apply:**

1. An asset is excluded if the use of the asset meets the following criteria:
 - (a) The private use of the asset is minor; and
 - (b) The main use of the asset is use in a business that is not a rental or charter business; and
 - (c) For a company or a trustee of a trust, the use of the asset places an obligation on the company or the trustee, as applicable, to pay fringe benefit tax or income tax.

Note:

- This exemption relates to concerns that an asset used predominantly for business purposes would otherwise fall within the rules.
- This excludes circumstances such as a helicopter that is generally used on a farm but is used for say 3% of its operating time for private purposes.
- “Minor” is undefined for these purposes and bears its ordinary meaning.
- Officials have stated that they prefer a test based on "use in the income year", rather than a “purpose of acquisition” test.

2. An asset is excluded if it is a residential property and its only income-earning use is as a long-term rental property.

This is so that a house occupied by an owner for the first part of the year, then left empty for a period of three months while they work in another part of the country, and then rented as an ordinary residential rental to a long-term tenant will not fall within the rules. Existing concepts for GST purposes will be used.

3. An asset is excluded if:
 - (a) It is being used in an income year by a person (person A); and
 - (b) During the income year, it undergoes a change of use; and
 - (c) The only uses made of the asset in the income year are the use by person A and the use by another person from which person A derives income.

Note: This rule is so that the mixed-use asset rules will not apply where there is actually no mixed-use:

- Boats and aircraft that are initially used privately by the owner and then undergo a change of use, and are rented out after that change of use – such as a boat that is used privately for the first part of the year, and then rented out during the second part of the year following the owner’s acquisition of a new boat for private use; or
- Assets that are initially rented out and then used exclusively for private use by the owner following the change of use.

[Section DG 3(4) as inserted by s. 30(1), and the *Officials’ Report to the Finance and Expenditure Committee on Submissions on the Bill*, pages 38 and 39 and Inland

	Revenue Policy and Strategy Special Report 14 August 2013 <i>Mixed-use assets</i> page 4.]
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SECTION I: WHICH ASSETS THE RULES APPLY TO (continued)

(8) Property being repaired by external contractors	<p>(8) Property being repaired by external contractors</p> <p>In response to a submission, officials commented as follows:</p> <p>“Periods when the property is unavailable due to it being repaired by external; contractors is not included in any private use under either the proposals as introduced or as recommended to be amended in this report. Officials have discussed this with the submitter, and the submitter has accepted this point.”</p> <p>[<i>The Officials’ Report to the Finance and Expenditure Committee on Submissions on the Bill</i>, page 50.]</p>
(9) What constitutes use	<p>(9) What constitutes use</p> <p>For the purposes of the mixed-use assets rules, the use of an asset is the active use of the asset for its intended purpose.</p> <p>[Sections DG 3(7) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>

SECTION I: WHICH ASSETS THE RULES APPLY TO (continued)

(10) Meaning of private use**(10) Meaning of private use**

1. Private use is the use of the asset by a natural person who is:
 - (a) The person who owns, leases, licences, or otherwise has the asset; or
 - (b) A person associated with the person who owns, leases, licences or otherwise has the asset:
2. The associated person test is extended by including people who have a voting interest of 5% or more, and whose share in the company gives them a right to use the asset. Two common situations which this rule will cover are:
 - (a) The asset is owned by a natural person and used by that person's close relative (see s. YB 4); and
 - (b) The asset is owned by a company (or trust or partnership), and used by a natural person who is associated with that company, a trust or partnership (see s. YB 3).
3. It is not necessary for the private use to be exclusive use. Use by a person who falls into one of the above categories will constitute private use even if the person uses the asset along with others – such as when the owner stays in the bach along with some of her friends, even if the friends pay market rental.
4. It makes no difference whether or not any income is derived from the private use. Use by a person who falls into one of the above categories will constitute private use regardless of any amount paid. However, any amount paid will be treated as exempt income under s. CW 8B(3), which states that an amount of income that a person derives in relation to the private use of an asset is exempt income.
5. Private use includes the use of an asset when income derived in relation to the use of the asset is an amount that is less than 80% of the *market value amount* (see **(5)** on page 7 above). The asset could be used by a person who is not associated with the owner. This is intended to capture situations such as when an asset is made available to a friend or a person otherwise connected with the owner for a price which is clearly lower than that ordinarily charged to renters with no connection with the owner. It is not intended to capture situations when an asset is rented by an unrelated person at a lower price for reasons such as:
 - (a) The asset is being rented in an “off-peak” or “quiet” period;
 - (b) The asset is being rented for a longer period than it is usually rented for; and
 - (c) The asset is rented at a reduced price to establish profile or a market share.

If the rate the asset is rented for would have been offered to any other person who wanted it for that period or during that time, that will be the market rate.
6. As with payment for the use of an asset by an associate, any amount received which is less than 80% of market value is not required to be returned as income for tax purposes, and use for which less than 80% of market value is paid does not constitute income-earning use for the purpose of the apportionment formula.

Inland Revenue is to publish guidance on records to be kept of private use.

[Sections DG 4(1) & (2) as inserted by s. 30(1) of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013*]

SECTION I: WHICH ASSETS THE RULES APPLY TO (continued)

<p>(11) Exclusions from private use: exclusion for ordinary business use</p>	<p>(11) Exclusions from private use: exclusion for ordinary business use</p> <p>The use of an asset is not private use if:</p> <p>(a) The asset is used to derive income for a particular period; and</p> <p>(b) The person uses the asset during the period solely in the ordinary course of their business.</p> <p>For example, a person who owns a boat will not be treated as using the boat privately when he or she takes out skippered fishing charters, if that is in the ordinary course of the business.</p> <p>Officials agreed there should be an exclusion from the concept of private use where the asset is used in a person's own business as part of the ordinary income earning process of that business – e.g. when a farmer uses his helicopter to check on stock.</p> <p>[Section DG 4(3) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i> and the <i>Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill</i>, page 47.]</p>
<p>(12) Exclusions from private use: exclusion for using an asset while repairing it</p>	<p>(12) Exclusions from private use: exclusion for using an asset while repairing it</p> <p>The use of an asset is not private use if:</p> <p>(a) The asset is used to derive income for a particular period; and</p> <p>(b) Damage is caused to the asset during the period; and</p> <p>(c) The damage is not the result of ordinary wear and tear; and</p> <p>(d) The person uses the asset after the end of the period to repair the damage; and</p> <p>(e) The use of the asset referred to in paragraph (d) is necessary in order for the person to carry out the repairs.</p> <p>Officials agreed that there may be circumstances when the owner of an asset – usually a bach – may need to stay in the bach to carry out repairs caused by a renter. For example, the owner might live some way away, and it will take more than one day to repair the damage. The use by the owner to repair the bach will not constitute private use.</p> <p>[Section DG 4(4) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i> and the <i>Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill</i>, page 49.]</p>

SECTION I: WHICH ASSETS THE RULES APPLY TO (continued)

<p>(13) Exclusions from private use: exclusion for using an asset while relocating it</p>	<p>(13) Exclusions from private use: exclusion for using an asset while relocating it</p> <p>The use of an asset is not private use if:</p> <ul style="list-style-type: none"> (a) The asset is used to derive income for a particular period in an income year; and (b) The person uses the asset before the start of the period, or after the end of the period, or both, to relocate the asset; and (c) The use referred to in paragraph (b) and the relocation of the asset are necessary for the income-earning purposes; and (d) The income the person derives for the income year from the use of the asset includes an amount payable for the cost of relocation. <p>This exemption covers situations when the owner uses the asset to relocate it at the beginning or end of a period of hire, and the income derived by the owner directly or indirectly includes an amount for the relocation.</p> <p>Officials agreed that when relocation costs are explicitly or implicitly incorporated in the amount charged for the asset, it is reasonable that there should be no private use.</p> <p>[Section DG 4(4) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i> and the <i>Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill</i>, page 49.]</p>
<p>(14) Use by an employee not associated with the owner is not private use</p>	<p>(14) Use by an employee not associated with the owner is not private use</p> <p>Following a submission, officials agreed that when a person using the asset is not the owner and is not associated with the owner – such as an employee – the use is not private use.</p> <p>[<i>Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill</i>, page 45.]</p>
<p>(15) Example of private use and private use exemptions</p>	<p>(15) Example of private use and private use exemptions</p> <p>Mary owns a launch. During the course of an income year, she takes her family out on the launch, she lets her brother use the launch (paying the market rate of \$200 per day) and she lets her friend use the launch (paying fuel costs only at the rate of \$50 per day).</p> <p>All these uses are instances of private use. The \$200 per day which Mary receives from her brother and the \$50 per day that Mary receives from her friend are exempt income so not subject to tax.</p> <p>When Mary rents out the launch to non-associates at market rates, takes the launch to another port for rental to non-associates at \$250 per day and then back again to the home port, or takes the launch to a boatyard for repair after damage was caused by a non-associate during a rental period, none of these instances is private use.</p> <p>[Inland Revenue <i>Special Report on Mixed-use assets</i> – 14 August 2013]</p>

SECTION I: WHICH ASSETS THE RULES APPLY TO (continued)

<p>(16) No exclusion from private use if exempt income is derived</p>	<p>(16) The exclusions from private use will not apply if exempt income is derived</p> <p>The private use exclusions discussed in (11), (12) & (13) on pages 11 – 12 above will not apply if the person derives any exempt income in relation to the use of the asset.</p> <p><u>When income from a mixed-use asset will be exempt:</u></p> <p>Income derived in respect of a use a mixed-use asset will be exempt:</p> <p>(a) Under s. CW 8B(2) if the person meets the “opting out” requirements of s. DG 21, and chooses to treat the income as exempt income under s. DG 21; or</p> <p>(b) Under s. CW 8B(3) if the income is derived in relation to the private use of the asset as described in s. DG 4(1) – as set out above. [This is a new exemption.]</p> <p><u>When these exemptions apply from:</u></p> <p>(a) The 2013-14 income year for land and improvements to land; and</p> <p>(b) The 2014-15 income year for ships, boats, water craft and aircraft.</p> <p>Under new s. CC 1(2B), an amount referred to in s. CW 8B is not a payment of rent or another amount for the purposes of s. CC 1.</p> <p>These rules under which income from private use is treated as exempt income essentially mean that the income will be outside the tax base and no deduction will be allowed.</p> <p>[Section DG 4(6) as inserted by s. 30(1), s. CW 8B as inserted by s. 13(1) and s. CC 1(2B) as inserted by s. 6(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>
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SECTION II: THE COMMENCEMENT DATE FOR INCOME TAX PURPOSES

<p>(1) Commencement date for income tax purposes</p>	<p>(1) Commencement date for income tax purposes</p> <p>The commencement date, for income tax purposes, differs depending on the type of mixed-use asset:</p> <p>(a) For a mixed-use asset that is land, including improvements to land, the rules apply for the 2013-14 and later income years.</p> <p>(b) For a mixed-use asset that is a boat or an aircraft, the rules apply for the 2014-15 and later income years.</p> <p>Officials preferred to retain the 2013-14 commencement date for short-term holiday accommodation, which they expected would be the bulk of mixed-use assets, because these assets would mostly be held in simple ownership structures.</p> <p>Boats and aircraft – in particular aircraft – will possibly be held in more complex structures for commercial (rather than tax) reasons. Therefore, officials consider that it would be reasonable to defer the implementation date for assets other than land until the beginning of the 2014-15 income year.</p> <p>[Section 30(2) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i> and the <i>Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill</i>, page 20.]</p>
<p>(2) No depreciation recovery on assets transferred from companies in 2013-14</p>	<p>(2) No depreciation recovery on assets transferred from companies in 2013-14</p> <p>1. A mixed-use asset owned by a <u>company</u> on 31 March 2013 is treated as being transferred out at its adjusted tax value on the date of transfer if:</p> <p>(a) A company has on 31 March 2013 an asset described in s. DG 3; and</p> <p>(b) The asset is transferred before the end of the company's 2013-14 income year to:</p> <p>(i) 1 or more of the company's shareholders in proportion to their shareholding; or</p> <p>(ii) 1 or more of the shareholders of a shareholder in proportion to their shareholding; and</p> <p>(c) The company chooses to apply this section.</p> <p>2. There will be no depreciation recovery income under sections CG 1, EE 1(3), EE 21 to EE 24, and EE 55 to EE 60, and the transfer is treated as if it were a disposal and acquisition for an amount equal to the adjusted tax value of the asset on the date of the transfer.</p> <p>Example in the rules: BoatCo has a boat on 31 March 2013 which meets the various requirements set out in subpart DG. All the shares in BoatCo are owned by Michelle. The boat has a market value of \$75,000, and an adjusted tax value of \$55,000. BoatCo transfers the boat to Michelle without payment (which is treated as a dividend of \$75,000). For depreciation purposes, BoatCo is treated as disposing of the boat for \$55,000, and Michelle is treated as acquiring it for \$55,000.</p> <p>[Section DZ 21 as inserted by s. 37 of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Bill</i> and the <i>Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill</i>, page 20.]</p>

SECTION III: THE APPORTIONMENT FORMULA

<p>(1) The apportionment formula</p>	<p>(1) The apportionment formula</p> <p>The apportionment formula is:</p> $\text{Expenditure} \times \frac{\text{income-earning days}}{(\text{income-earning days} + \text{counted days})}$ <p>Expenditure is:</p> <ol style="list-style-type: none"> 1. All expenditure on repairs and maintenance, except for extraordinary repairs that are dealt with under s. DG 4(4) and were caused by income earning use; and 2. The total expenditure or loss, including depreciation, and interest expenditure for qualifying companies and persons that are not companies, that is incurred by the person for an income year in relation to the asset, and that would be deductible in the absence of this subpart, <u>other than</u> expenditure that is: <ol style="list-style-type: none"> (a) Related solely to the income-earning use of the asset as described in s. DG 7: <ol style="list-style-type: none"> (i) Expenditure that relates solely to the use of an asset for deriving income of the person, other than exempt income; and (ii) Expenditure: <ol style="list-style-type: none"> a. From which the person, or if the person is a company an <u>associate</u> of the person, would not reasonably expect to receive a personal benefit (this is discussed and supported on page 57 of the <i>Officials' Report</i>); or b. That the person must reasonably incur to meet a regulatory requirement so that they may use the asset for deriving income and that would not have been incurred but for the requirement; or (b) Related solely to the private use of the asset: <p>Income-earning days is the total number of days (or other unit of measurement, such as hours, nights, etc. that may be more appropriate) in the income year for which the person derives income from the use of the asset (other than income derived from the private use of an asset that is exempt income under s. CW 8B(3)), including any days on which:</p> <ol style="list-style-type: none"> 1. The use made of the asset is use described in s. DG 4(3) to (5); or 2. The asset has become unavailable for use because another person who had earlier reserved the asset for their own use, subsequently did not take advantage of that reservation; or 3. A fringe benefit tax liability arises: <p>[Note: Officials agreed that when an asset is booked and paid for but the person does not show up is an income-earning period. Officials also agreed that where FBT applies, or the provision of accommodation gives rise to an income tax liability, the use should be treated as an income-earning day.]</p> <p>Counted days is the total number of days in the income year on which the asset is in use, and the day is not an income-earning day as described above.</p> <p>[Sections DG 8, DG 9 & DG 7 as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i> and <i>Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill</i>, pages 24, 44 & 57.]</p>
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SECTION III: THE APPORTIONMENT FORMULA (continued)

<p>(2) Treatment of interest expenditure</p>	<p>(2) Treatment of interest expenditure</p> <ol style="list-style-type: none"> 1. The rules in subpart DG override sections DB 5, DB 7 and DB 8 in relation to expenditure that subpart DG applies to. 2. Interest expenditure, for a person to whom the mixed-use assets rules apply, means expenditure on interest, and includes an amount of interest on the sum of the outstanding balances of financial arrangements entered into by the person, if the financial arrangement: <ol style="list-style-type: none"> (a) Provides funds to the person; and (b) Gives rise to an amount for which the person would have a deduction. 3. If the person is not a company, or the person is a qualifying company: an amount of interest expenditure incurred in relation to an asset is included as the item Expenditure in the apportionment formula. 4. If the person is a company other than a qualifying company, an amount of interest expenditure incurred in relation to an asset is apportioned under the interest apportionment rules in section DG 11. 5. Note that if the person is a qualifying company, they are treated for the purposes of the mixed-use assets rules as a person that is not a company. 6. Interest expenditure does not include a deduction for an amount that arises only from movement in currency exchange rates. <p>[Section DG 5 as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>
<p>(3) Treatment of depreciation recovery income and loss on disposal</p>	<p>(3) Treatment of depreciation recovery income and loss on disposal</p> <p>As noted above, depreciation expenditure is subject to the apportionment rule.</p> <p>The rules relating to depreciation recovery income and losses on disposals of mixed-use assets are as follows:</p> <ol style="list-style-type: none"> (a) Depreciation recovery income is calculated under s. EE 49, which deals with depreciation recovery income when an asset is partly used for business. (b) Depreciation loss on disposal is dealt with under sections EE 44 to EE 48 and EE 50(6) and (7); and (c) The formula for depreciation loss in s. EE 50(2) is not used. <p>Officials commented that the policy intention behind the relevant depreciation rule is that only a proportion of the depreciation recovered will be taxable, reflecting that only a proportion of the depreciation allowed was deductible. The relevant provision in the depreciation legislation clearly refers to the depreciation that has actually been allowed, which is the amount after apportionment.</p> <p>[Section DG 8(2) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i> and the <i>Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill</i>, page 63.]</p>

SECTION III: THE APPORTIONMENT FORMULA (continued)

<p>(4) Associated persons: standard rule modified</p>	<p>(4) Associated persons: standard rule modified</p> <p>For the purposes of the mixed-use assets rules, a company and a person other than a company are associated persons if:</p> <p>(a) The person has a voting interest in the company of 5% or more; or</p> <p>(b) The person’s share in the company gives them a right to use the asset.</p> <p>Note: Officials accepted a submission that the associated persons test should not be varied from 25% to 5%. Officials stated that:</p> <p>“The original intention of this amendment was to refine the targeting of the rules to companies controlled by 10 or fewer shareholders. However, the amendment is ineffective to do that, and officials recommend that it be removed.”</p> <p>However, it has not been removed.</p> <p>[Section DG 6 as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>
<p>(5) Expenditure that is apportioned based on space, floor area or similar basis</p>	<p>(5) Expenditure that is apportioned based on space, floor area or similar basis</p> <p>If some or all of the expenditure on an asset is apportioned for tax purposes on the basis of space, floor area, or on another similar basis, that method of apportionment overrides the mixed-use assets rules to the extent of the amount of the deduction.</p> <p>[Section DG 8(2)(a) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>

SECTION IV: THE INTEREST APPORTIONMENT RULES

<p>(1) Interest apportionment rules apply to companies, group companies, and shareholders</p>	<p>(1) Interest apportionment rules apply to companies, group companies, and shareholders</p> <p>The interest apportionment rules applying to companies are contained in sections DG 10 to DG 14.</p> <p>Those sections provide for the apportionment of interest expenditure incurred by:</p> <ul style="list-style-type: none"> (a) A <u>company</u> that has a mixed-use asset; and (b) Other companies in the same group of companies; and (c) Shareholders. <p>Companies must provide information disclosure statements under section 30D of the <i>Tax Administration Act 1994</i> to enable the calculations to be made.</p> <p>[Section DG 10(1) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>
<p>(2) Information disclosure statements required by companies</p>	<p>(2) Information disclosure statements required by companies</p> <ol style="list-style-type: none"> 1. Section 30D of the <i>Tax Administration Act 1994</i> applies for an income year to a company to which 1 or more of sections DG 11 to DG 19 (the interest apportionment rules and the expenditure quarantining rules) of the <i>Income Tax Act 2007</i> applies; 2. The company must provide the following information, as applicable, <u>to every shareholder of the company</u> for the income year to enable the shareholder to calculate the amount of a deduction that may be allowed for the income year in relation to a mixed-use asset to which subpart DG of that Act applies: <ul style="list-style-type: none"> (a) Their share of a net asset balance for the income year – see page 21 below; (b) Their share of an outstanding profit balance for the income year – see pages 29 – 30 below; (c) Other necessary information for the income year. <p>[Section 30D of the <i>Tax Administration Act 1994</i> as inserted by s. 110 of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>

SECTION IV: THE INTEREST APPORTIONMENT RULES (continued)

(3) Exclusion for companies with minority shareholders	<p>(3) Exclusion for companies with minority shareholders</p> <p>For the purposes of subpart DG, a group of companies is treated as a wholly-owned group of companies.</p> <ol style="list-style-type: none"> 1. However, a company (company A) that is treated as part of a wholly-owned group under this subpart, but is not part of a wholly-owned group for the other purposes of the Income Tax Act, is excluded from the interest expenditure rules in sections DG 11 to DG 14 for an income year if: <ol style="list-style-type: none"> (a) No private use of an asset of a company in the group has been made in the income year by a shareholder (or any non-shareholder associated with the shareholder) of company A; and (b) No tax losses have been made available under subpart IC between company A and other companies in the group. [<u>Note: this rule appears to function both ways – if company A has made available tax losses or if company A uses tax losses.</u>] 2. Note: officials declined to allow an ordering rule to determine which group company should first have its interest apportioned. The proposals allow the members of the group to determine amongst themselves in which order to apply the interest apportionment rules. However, officials accepted that concerns may arise when non-wholly owned companies are included in the group, and proposed that when a non-wholly owned company is included in the same group as the mixed-use asset company, it can be excluded from the interest apportionment rules entirely if: <ol style="list-style-type: none"> (a) No minority shareholder of the company, or person associated with them, has had private use of the asset; and (b) There has been no loss offset with, or no loss subvention payments from, the company. (c) This modification to the interest apportionment rules will flow through to the deduction quarantining rules. <p>[Section DG 10(2) and (6) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i> and the <i>Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill</i>, pages 62 and 68.]</p>
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SECTION IV: THE INTEREST APPORTIONMENT RULES (continued)

(4) Exclusion for corporate and non-corporate shareholders	<p>(4) Exclusion for corporate and non-corporate minority shareholders</p> <p>For the purposes of subpart DG, a group of companies is treated as a wholly-owned group of companies.</p> <ol style="list-style-type: none"> 1. The interest apportionment rules in s. DG 13 do not apply to a <i>corporate shareholder</i> if: <ol style="list-style-type: none"> (a) The shareholder (including non-shareholders who are associated with the shareholder) has a direct or indirect interest of less than 50% in the company that has the asset; and (b) The shareholder (including non-shareholders who are associated with the shareholder) has <u>not enjoyed any private use</u> of the asset. 2. The interest apportionment rules in s. DG 14 do not apply to a <i>shareholder</i> if: <ol style="list-style-type: none"> (a) The shareholder (including non-shareholders who are associated with the shareholder) has a direct or indirect interest of less than 50% in the company that has the asset; and (b) The shareholder (including non-shareholders who are associated with the shareholder) has <u>not enjoyed any private use</u> of the asset. <p>[Section DG 10(3), (4) and (6) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i> and the <i>Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill</i>, pages 62 and 68.]</p>
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SECTION IV: THE INTEREST APPORTIONMENT RULES (continued)

(5) Meaning of asset value and debt value**(5) Meaning of asset value and debt value**

When a close company has a mixed-use asset, and also incurs interest expenditure, it is necessary to determine the close company's "asset value" and "debt value" for the purposes of applying the interest apportionment rules.

1. Asset value means the value of the asset *at the end of an income year*, using:

(a) For land, including an improvement to land, the amount given by the later of either its most recent capital value or annual value (as set by the relevant local authority), or its cost on acquisition (or market value, if the transaction involves an associated person);

[Note: officials stated they are reluctant to allow registered valuations to be used as an alternative to the valuation given for rating purposes because such choices would allow taxpayers to "game" the rules. However, they noted that legislative reference could usefully be clarified, perhaps by reference to the concepts of annual value, capital value and land value in section 13(3) of the Local Government (Rating) Act 2002.]

(b) For other property, its adjusted tax value.

[Note: officials note that because the interest provisions assess the current debt position of the company, it makes sense that this is assessed against the current asset value of the company. However, it is inconsistent to use cost as the basis for assets that decline in value. Therefore, for non-land assets, the tax book value for depreciation purposes is a reasonable proxy for the current value of these assets.]

2. Debt value:

(a) Means the average outstanding amount that gives rise to the *interest* payable by the company, measured by reference to the amounts outstanding at the start of and at the end of an income year; and

[Note: for what constitutes interest for the purposes of the mixed-use assets rules, see **page 14** above. Note that interest for the purposes of these rules does not include amounts paid on fixed-rate foreign equity or fixed-rate shares and stapled debt securities – as these amounts are not deductible in any case.]

(b) For a person who has, in the income year, more than 1 mixed-use asset to which these rules apply, the **company's debt value** referred to in **sections DG (5)(c), DG 12(6)(c) and DG 13(8)(c)** is reduced by an amount previously taken into account under the mixed-use assets rules for the income year.

[Note: Officials agreed with a submission that the rules as initially introduced did not work if a company has more than one mixed-use asset, and the legislation has been amended to take account of this.]

[**Section DG 11(8) and (9)** as inserted by **s. 30(1)** of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013* and the *Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill*, pages 52, 58, 59 and 66.]

SECTION V: THE INTEREST APPORTIONMENT RULE WHEN DEBT VALUE EXCEEDS ASSET VALUE

<p>(1) Interest apportionment rule when debt value exceeds asset value</p>	<p>(1) Interest apportionment rule when debt value exceeds asset value</p> <p>When the company that has the mixed-use asset has a debt value that exceeds the asset value, the company must calculate the reduced interest for the income year that will be subject to the apportionment formula as follows:</p> $\left(\begin{array}{l} \text{Company's reduced interest} \\ \text{subject to apportionment} \end{array} \right) = \left(\begin{array}{l} \text{company's total interest} \\ \text{for the income year} \end{array} \right) \times \frac{\left(\begin{array}{l} \text{company's asset value} \\ \text{for the income year} \end{array} \right)}{\left(\begin{array}{l} \text{company's debt value} \\ \text{for the income year} \end{array} \right)}$ <p>The company is then allowed a deduction for the income year of a proportion of the reduced interest calculated under the general apportionment formula in s. DG 9(2):</p> $\left(\begin{array}{l} \text{Deductible portion} \\ \text{of reduced interest} \end{array} \right) = \left(\begin{array}{l} \text{company's reduced interest} \\ \text{subject to apportionment} \end{array} \right) \times \frac{\text{income-earning days}}{(\text{income-earning days} + \text{counted days})}$ <p>[Section DG 11(4) to (6) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>
<p>(2) This rule will not apply to qualifying companies</p>	<p>(2) This rule will not apply to qualifying companies</p> <p>Qualifying companies cannot apply this rule even if their debt value exceeds their asset value. QCs must apply the rules as if the asset value exceeds their debt value.</p> <p>Officials noted that qualifying companies are not subject to the rule under which all interest they incur is deductible, so interest apportionment inside qualifying companies should therefore be on a tracing basis. However, for the rules to operate fairly, it still remains necessary to consider interest incurred by shareholders to acquire their shares in the qualifying company, and potentially apply apportionment to such interest.</p> <p>[Section DG 10(5) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i> and the <i>Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill</i>, pages 54-55.]</p>
<p>(3) Example in the legislation</p>	<p>(3) Example in the legislation</p> <p>Boat Ltd has a charter boat whose cost is \$60,000. The company has debt of \$100,000, with associated interest expenditure of \$10,000. Since the debt value is more than the asset value, the company must apportion interest expenditure of \$6,000 (section DG 11(4)-(6)). The formula is $\\$10,000 \times (\\$60,000/\\$100,000) = \\$6,000$.</p> <p>[Section DG 11 as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>

SECTION VI: THE INTEREST APPORTIONMENT RULES WHEN ASSET VALUE EXCEEDS DEBT VALUE

<p>(1) Interest apportionment rule when debt value exceeds asset value</p>	<p>(1) Interest apportionment rule when asset value exceeds debt value</p> <p>When the company that has the mixed-use asset has a debt value that is less than the asset value, the company's own deduction for interest under the mixed-use assets rules, calculated under the general apportionment formula in s. DG 9(2), is:</p> $\left(\begin{array}{l} \text{Deductible portion} \\ \text{of company's interest} \end{array} \right) = (\text{company's interest}) \times \frac{\text{income-earning days}}{(\text{income-earning days} + \text{counted days})}$ <p>[Section DG 11(3) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>
<p>(2) Calculation of net asset balance</p>	<p>(2) Calculation of net asset balance</p> <p>The company must calculate the net asset balance to be used in the group company and shareholder interest apportionment calculations as follows:</p> <p style="text-align: center;">net asset balance = company's asset value - company's debt value</p> <p>[Section DG 11(7) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>
<p>(3) This rule applies to qualifying companies</p>	<p>(3) This rule applies to qualifying companies</p> <p>QCs must apply this rule, and if the net asset balance is greater than zero, they must apply the group company and shareholder apportionment rules.</p> <p>[Section DG 10(5) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i> and the <i>Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill</i>, pages 54-55.]</p>
<p>(4) Application of positive net asset balance to other group companies</p>	<p>(4) Application of positive net asset balance to other group companies</p> <ol style="list-style-type: none"> 1. The interest apportionment rule is extended to other companies that have interest deductions and are in the same group of companies as the close company or qualifying company with the mixed-use asset if: <ol style="list-style-type: none"> (a) The close company or qualifying company has a net asset balance; and (b) There are other companies in the same group with interest deductions. 2. The interest apportionment is applied sequentially to every group company until: <ol style="list-style-type: none"> (a) The net asset balance for the income year is reduced to zero or is treated as reduced to zero; or (b) No other group companies exist to which the group company apportionment rule can apply. <p>[Section DG 12(1) and (2) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>

SECTION VI: THE INTEREST APPORTIONMENT RULES WHEN ASSET VALUE EXCEEDS DEBT VALUE

<p>(5) Group company apportionment when group company debt value exceeds the net asset balance</p>	<p>(5) Group company apportionment when group company debt value exceeds the net asset balance</p> <p>The company with the mixed-use asset is referred to as “company A”.</p> <p>The group company is referred to as “company B”.</p> <ol style="list-style-type: none"> 1. If company B’s debt value for the income year is more than the net asset balance for the income year, company B has a reduced amount of interest expenditure for the income year calculated as follows: $\left(\text{Company B's reduced interest expenditure} \right) = \left(\text{company B's total interest for the income year} \right) \times \frac{\left(\text{net asset balance for the income year} \right)}{\left(\text{company B's debt value for the income year} \right)}$ <ol style="list-style-type: none"> 2. Company B is then allowed a deduction for the income year of a proportion of the reduced interest calculated under the general apportionment formula in s. DG 9(2) as if company B was the mixed-use asset owning company: $\left(\text{Company B's deductible reduced interest} \right) = \left(\text{company B's reduced interest expenditure} \right) \times \frac{\text{income - earning days}}{\left(\text{income - earning days} + \text{counted days} \right)}$ <ol style="list-style-type: none"> 3. The remaining net asset balance is treated as zero. <p>[Section DG 12(5) to (8) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>
<p>(6) Group company apportionment when net asset balance exceeds group company debt value</p>	<p>(6) Group company apportionment when net asset balance exceeds group company debt value</p> <p>If company B’s debt value for the income year is equal to or less than the net asset balance for the income year:</p> <ol style="list-style-type: none"> 1. Company B is allowed a deduction for the income year of a proportion of its total interest calculated under the general apportionment formula in s. DG 9(2) as if company B was the mixed-use asset owning company: $\left(\text{Company B's deductible interest} \right) = \left(\text{company B's total interest expenditure} \right) \times \frac{\text{income - earning days}}{\left(\text{income - earning days} + \text{counted days} \right)}$ <ol style="list-style-type: none"> 2. The net asset balance is then recalculated by deducting company B’s debt value. 3. If the recalculated net asset balance is positive, then the group company apportionment exercise must be undertaken again with the next group company – essentially redoing (5) and (6) on this page. 4. If the recalculated net asset balance is still positive after all group companies, then the remaining net asset balance must be allocated to shareholders under sections DG 13 and DG 14. <p>[Section DG 12(3), (4) and (9) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>

SECTION VI: THE INTEREST APPORTIONMENT RULES WHEN ASSET VALUE EXCEEDS DEBT VALUE

(7) Application to corporate shareholders**(7) Application to corporate shareholders**

1. The interest apportionment is extended to corporate shareholders if:
 - (a) A net asset balance remains outstanding for the income year after applying:
 - (i) The group company interest apportionment rules (if there are group companies); or
 - (ii) The mixed-use asset owning company interest apportionment rule (if there are no group companies); and
 - (b) There are corporate shareholders (ignoring the look-through rule in **s. YC 4** that would attribute a company's shareholding to its own shareholders or anyone else, and ignoring any zero voting interests), none of which is in the same group of companies as the mixed-use asset owning company, as follows:
 - (i) A company that is a shareholder in the mixed-use asset owning company;
 - (ii) A company that is a shareholder in a company that is in the same group of companies as the mixed-use asset company;
 - (iii) A company that has a voting interest in a company referred to in subparagraph (i) or (ii) above.
2. The interest apportionment is extended sequentially as follows:
 - (a) First, to companies referred to in (1)(b)(i) and (ii); and
 - (b) Secondly, to the extent to which the debt value of the company for the income year remains less than the company's share of the net asset balance, to companies that are shareholders in a company referred to in paragraph (a) – ignoring the look-through rule that would attribute the shareholdings of such companies to their shareholders or anyone else; and
 - (c) So on, until:
 - (i) The company's share of the net asset balance for the income year is reduced to zero or is treated as reduced to zero; or
 - (ii) No other corporate shareholders exist to which the interest apportionment can be extended.
3. The interest apportionment is applied to each corporate shareholder according to its share of any remaining net asset balance after sequentially applying the apportionment to the mixed-use asset owning company, other group companies, and other corporate shareholders that are earlier in the application sequence:

$$\left(\begin{array}{l} \text{corporate shareholder's} \\ \text{share of the} \\ \text{net asset balance} \end{array} \right) = \left(\begin{array}{l} \text{remaining net asset balance} \\ \text{after sequentially applying} \\ \text{interest apportionment} \end{array} \right) \times \left(\begin{array}{l} \text{corporate} \\ \text{shareholder's} \\ \text{interest} \end{array} \right)$$

[Sections DG 13(1) to (4) and DG 2(6) as inserted by s. 30(1) of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013*]

SECTION VI: THE INTEREST APPORTIONMENT RULES WHEN ASSET VALUE EXCEEDS DEBT VALUE

<p>(8) Corporate shareholder interest apportionment when corporate shareholder debt value exceeds the net asset balance</p>	<p>(8) Corporate shareholder interest apportionment when corporate shareholder debt value exceeds the net asset balance</p> <p>1. If corporate shareholder's debt value for the income year is more than its share of the net asset balance for the income year, the corporate shareholder has a reduced amount of interest expenditure for the income year calculated as follows:</p> $\left(\begin{array}{l} \text{Corporate shareholder's} \\ \text{reduced} \\ \text{interest expenditure} \end{array} \right) = \left(\begin{array}{l} \text{corporate shareholder's} \\ \text{total interest} \\ \text{for the income year} \end{array} \right) \times \left(\begin{array}{l} \text{corporate shareholder's} \\ \text{net asset balance} \\ \text{for the income year} \\ \hline \text{corporate shareholder's} \\ \text{debt value} \\ \text{for the income year} \end{array} \right)$ <p>2. The corporate shareholder is then allowed a deduction for the income year of a proportion of the reduced interest calculated under the general apportionment formula in s. DG 9(2) as if the corporate shareholder was the mixed-use asset owning company:</p> $\left(\begin{array}{l} \text{Corporate shareholder's} \\ \text{deductible} \\ \text{reduced interest} \end{array} \right) = \left(\begin{array}{l} \text{corporate shareholder's} \\ \text{reduced} \\ \text{interest expenditure} \end{array} \right) \times \frac{\text{income - earning days}}{(\text{income - earning days} + \text{counted days})}$ <p>3. The remaining net asset balance is treated as zero.</p> <p>[Section DG 13(7) to (10) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>
<p>(9) Corporate shareholder interest apportionment when the net asset balance exceeds the corporate shareholder's debt value</p>	<p>(9) Corporate shareholder interest apportionment when the net asset balance exceeds the corporate shareholder's debt value</p> <p>If the corporate shareholder's debt value for the income year is equal to or less than the net asset balance for the income year:</p> <p>1. The corporate shareholder is allowed a deduction for the income year of a proportion of its total interest calculated under the general apportionment formula in s. DG 9(2) as if company B was the mixed-use asset owning company:</p> $\left(\begin{array}{l} \text{Corporate shareholder's} \\ \text{deductible interest} \end{array} \right) = \left(\begin{array}{l} \text{corporate shareholder's} \\ \text{total interest expenditure} \end{array} \right) \times \frac{\text{income - earning days}}{(\text{income - earning days} + \text{counted days})}$ <p>2. The net asset balance is then recalculated by deducting the corporate shareholder's debt value</p> <p>3. If the recalculated net asset balance is positive, then the corporate shareholder apportionment exercise must be undertaken again with the next group company – essentially redoing (8) and (9) on this page.</p> <p>4. If the recalculated net asset balance is still positive after all corporate shareholders, then the remaining net asset balance must be allocated to non-corporate shareholders under s. DG 14.</p> <p>[Section DG 13(5), (6) and (11) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>

SECTION VI: THE INTEREST APPORTIONMENT RULES WHEN ASSET VALUE EXCEEDS DEBT VALUE

<p>(10) Example in the legislation of mixed-use owning company's apportionment</p>	<p>(10) Example in the legislation of mixed-use owning company's apportionment</p> <p>Holiday Home Ltd holds a holiday home with a rateable value of \$200,000.</p> <p>The company has debt of \$40,000, with associated interest expenditure of \$4,000.</p> <p>Since the debt value is less than the asset value, all the interest expenditure must be apportioned (s. DG 11(3)).</p> <p>[Section DG 11 as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>
<p>(11) Example in the legislation of a group company's interest apportionment</p>	<p>(11) Example in the legislation of a group company's interest apportionment</p> <p>Holiday Home Ltd has an asset balance of \$160,000 (\$200,000 less \$40,000) and is wholly owned by Parent Ltd.</p> <p>Parent has debt of \$30,000, with associated interest expenditure of \$3,000.</p> <p>Since Parent's debt value is less than the asset balance, all of Parent's interest expenditure must be apportioned (s. DG 12(3)).</p> <p>[Section DG 12 as inserted by Clause 19(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>
<p>(12) Example in the legislation of a corporate shareholder's apportionment</p>	<p>(12) Example in the legislation of a corporate shareholder's apportionment</p> <p>Parent Ltd has two equal corporate shareholders, company Y, which has debt of \$20,000 with associated interest expenditure of \$2,000, and company Z, which has debt of \$70,000 with associated interest expenditure of \$7,000.</p> <p>Both companies, share of the net asset balance is \$65,000 ($\\$130,000 \times 50\%$).</p> <p>Since company Y's debt value is less than its share of the net asset balance, all its interest expenditure must be apportioned (s. DG 13(5)).</p> <p>Company Z's debt value is greater than its share of the net asset balance, so it must apportion interest expenditure of \$6,500 (s. DG 13(7)-(9)).</p> <p>The formula is $\\$7,000 \times (\\$65,000/\\$70,000) = \\$6,500$.</p> <p>[Section DG 13 as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>

SECTION VI: THE INTEREST APPORTIONMENT RULES WHEN ASSET VALUE EXCEEDS DEBT VALUE

**(13)
Application to
non-corporate
shareholders****(13) Application to non-corporate shareholders**

1. The interest apportionment is extended to non-corporate shareholders if:
 - (a) A net asset balance remains outstanding for the income year after sequentially having applied:
 - (i) The corporate shareholder interest apportionment rules in **s. DG 13** (if there are corporate shareholders); or
 - (ii) The group company interest apportionment rules in **s. DG 12** (if there are group companies); or
 - (iii) The mixed-use asset owning company interest apportionment rule in **s. DG 11**; and
 - (b) A person exists who:
 - (i) Is not a company, other than a company acting as a trustee; and
 - (ii) Has a voting interest in the mixed-use asset owning company; and
 - (iii) Has interest expenditure for which they are allowed a deduction.
2. The interest apportionment is extended sequentially using the same rules as those that apply to corporate shareholders in **s. DG 13(2) to (10)**, treating the person as if they were the company, as follows:
 - (a) First, to non-corporate shareholders in the mixed-use asset owning company itself and non-corporate shareholders in other group companies; and
 - (b) Secondly, to the extent to which the debt value of the non-corporate shareholder for the income year remains less than the non-corporate shareholder's share of the net asset balance, to non-corporate shareholders of a corporate shareholder of the mixed-use asset owning company or of a group company; and
 - (c) So on, until:
 - (i) The non-corporate shareholder's share of the net asset balance for the income year is reduced to zero or is treated as reduced to zero; or
 - (ii) No other non-corporate shareholders exist to which the interest apportionment can be extended.
3. The interest apportionment is applied to each non-corporate shareholder according to its share of any remaining net asset balance after sequentially applying the apportionment to the mixed-use asset owning company under **s. DG 11**, other group companies under **s. DG 12**, corporate shareholders under **s. DG 13**, and other non-corporate shareholders earlier in the application sequence:

$$\left(\begin{array}{l} \text{Non-corporate} \\ \text{shareholder's} \\ \text{share of the} \\ \text{net asset balance} \end{array} \right) = \left(\begin{array}{l} \text{remaining net asset balance} \\ \text{after sequentially applying} \\ \text{interest apportionment} \end{array} \right) \times \left(\begin{array}{l} \text{non-corporate} \\ \text{shareholder's} \\ \text{interest} \end{array} \right)$$

[Sections **DG 13(1) to (4)** and **DG 2(6)** as inserted by **s. 30(1)** of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013*]

SECTION VI: THE INTEREST APPORTIONMENT RULES WHEN ASSET VALUE EXCEEDS DEBT VALUE

(14) Example in legislation of the non-corporate shareholder's apportionment	(14) Example in legislation of the non-corporate shareholder's apportionment
	Company Y has two shareholders: Thomas, who has borrowed \$200,000 to acquire a 50% interest in the company, and Brent, who has borrowed \$10,000 to buy his 50% interest.
	Each has a share of the remaining net asset balance of \$22,500. The formula is $(\$65,000 - \$20,000) \times 50\% = \$22,500$.
	Since Thomas's debt value is greater than his share of the net asset balance, Thomas must apportion 11.25% of his total interest expenditure (sections DG 14 and DG 13(7)-(9)).
	The formula is $22,500/200,000$. Since Brent's debt value is less than his share of the net asset balance, all Brent's interest expenditure must be apportioned (sections DG 14 and DG 13(5))
	[Section DG 14 as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]

SECTION VII: QUARANTINED EXPENDITURE TREATMENT FOR MIXED-USE ASSET OWNERS

(1) Income threshold for quarantining to apply	<p>(1) Income threshold for quarantining to apply</p> <p>A person's deduction for an income year, after apportionment, is quarantined and denied as a deduction for the income year, and the quarantined amount may be allocated to a later income year when the income derived is sufficient to offset the expenditure, under the following circumstances:</p> <p>(a) A mixed-use asset owner incurs expenditure for which a deduction is limited under s. DG 8 and the formula in s. DG 9(2), or a close company that owns a mixed-use asset has its expenditure limited under s. DG 11; and</p> <p>(b) The amount of income derived for the income year from the use of an asset, other than an amount of exempt income, <u>is less than 2% of</u>:</p> <p>(i) For land, including an improvement to land, the amount given by the later of either its most recent capital value or annual value (as set by the relevant local authority) or its cost on acquisition (or market value, if the transaction involves an associated person):</p> <p>(ii) For other property to which this subpart applies, its adjusted tax value.</p> <p>(c) Companies must provide information disclosure statements under section 30D of the <i>Tax Administration Act 1994</i> to enable the calculations to be made.</p> <p>Note:</p> <ol style="list-style-type: none"> 1. Officials stated they are reluctant to allow registered valuations to be used as an alternative to the valuation given for rating purposes because such choices would allow taxpayers to “game” the rules. However, they noted that legislative reference could usefully be clarified, perhaps by reference to the concepts of annual value, capital value and land value in section 13(3) of the <i>Local Government (Rating) Act 2002</i>. 2. Officials note that because the interest provisions assess the current debt position of the company, it makes sense that this is assessed against the current asset value of the company. However, it is inconsistent to use cost as the basis for assets which decline in value. Therefore, for non-land assets, the tax book value for depreciation purposes is a reasonable proxy for the current value of these assets. 3. Officials have also stated that because income from associated persons is excluded income and not subject to tax, such excluded income will not be included in the 2% deduction quarantining threshold. <p>[Section DG 16(1) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i> and the <i>Officials’ Report to the Finance and Expenditure Committee on Submissions on the Bill</i> pages 58, 64, and 66]</p>
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SECTION VII: QUARANTINED EXPENDITURE TREATMENT FOR MIXED-USE ASSET OWNERS

<p>(2) Calculation of quarantined amount</p>	<p>(2) Calculation of quarantined amount</p> <p>1. The amount of expenditure that is quarantined and for which a deduction is denied in the income year is calculated as follows:</p> $\text{Quarantined amount} = [\text{expenditure}] - [\text{asset income}]$ <p>=</p> $\left[\begin{array}{l} \text{Deductions allowed} \\ \text{after apportionment} \\ \text{under mixed-use} \\ \text{rules in s.DG8 \& DG11} \end{array} \right] + \left[\begin{array}{l} \text{Amounts quarantined} \\ \text{for earlier income years} \\ \text{and not yet allocated} \\ \text{to an income year} \end{array} \right] - \left[\begin{array}{l} \text{Total income} \\ \text{(other than exempt income)} \\ \text{derived for the income year} \\ \text{from the use of the asset} \end{array} \right]$ <p>2. For the purposes of expenditure denial, if asset income exceeds expenditure, the result is treated as zero.</p> <p>3. For the purposes of allocation of quarantined expenditure to a later income year, if expenditure is less than asset income, the excess income is the outstanding profit balance for the income year:</p> $(\text{Asset income}) - (\text{expenditure}) = \left(\begin{array}{l} \text{outstanding profit balance} \\ \text{for the income year} \end{array} \right)$ <p>[Section DG 16(2) to (6) as inserted by s. 30(1) of the Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013]</p>
<p>(3) Quarantining example in legislation for mixed-use asset owners</p>	<p>(3) Quarantining example in legislation for mixed-use asset owners</p> <p>David has a city apartment with a rateable value of \$300,000.</p> <p>He rents out the apartment and also uses it privately.</p> <p>He receives market rate rental of \$4,000 from non-associates, and \$6,000 from associates.</p> <p>David's total allowable expenditure, under sections DG 7, DG 8, and DG 11, is \$15,000.</p> <p>Since David's income from non-associates is less than 2% of the apartment's rateable value, the excess expenditure of \$5,000 is denied as a deduction.</p> <p>The amount denied may be allocated to a later income year under section DG 17.</p> <p>[Section DG 16 as inserted by s. 30(1) of the Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013]</p>

SECTION VII: QUARANTINED EXPENDITURE TREATMENT FOR MIXED-USE ASSET OWNERS

(4) Allocation of quarantined amounts for mixed-use asset owners**(4) Allocation of quarantined amounts for mixed-use asset owners**

1. A person may allocate expenditure relating to an asset that was quarantined in an earlier income year to the current year if:

$$\left(\begin{array}{l} \text{The person's income} \\ \text{for the current year} \\ \text{from the use of the asset} \end{array} \right) > \left(\begin{array}{l} \text{The person's deductions} \\ \text{after apportionment} \\ \text{under s. DG8 \& DG11} \end{array} \right)$$

2. The amount of previously quarantined expenditure that is quarantined that the person is allowed as a deduction for the current year must not exceed the lesser of:

(a) The excess expenditure quarantined in relation to the asset – see the *Officials' Report* page 67 - in earlier income years; and

(b) The amount – the current year excess - calculated as follows:

$$\text{[Asset income]} - \text{[expenditure]}$$

$$= \left[\begin{array}{l} \text{Total income derived} \\ \text{for the current year} \\ \text{from the use of the asset} \end{array} \right] - \left[\begin{array}{l} \text{Deductions allowed} \\ \text{in relation to the asset} \\ \text{for the current year} \\ \text{after apportionment} \\ \text{under s.DG8 \& DG11} \end{array} \right]$$

3. If the lesser amount is the quarantined expenditure brought forward from earlier years, an outstanding profit balance arises as follows:

$$\left[\begin{array}{l} \text{Outstanding} \\ \text{profit} \\ \text{balance} \\ \text{to use} \\ \text{under s.DG19} \end{array} \right] = \left[\begin{array}{l} \text{Total income derived} \\ \text{for the current year} \\ \text{from the use of the asset} \end{array} \right] - \left[\begin{array}{l} \text{Deductions allowed} \\ \text{in relation to the asset} \\ \text{for the current year} \\ \text{after apportionment} \\ \text{under s.DG8 \& DG11} \end{array} \right] - \left[\begin{array}{l} \text{quarantined expenditure} \\ \text{in relation to the asset} \\ \text{brought forward} \\ \text{from earlier income years} \end{array} \right]$$

4. If expenditure for the current year exceeds the current year asset income, the current year excess is treated as zero, and no previously quarantined expenditure can be allocated to the current year

Note that officials commented that the policy intention is that quarantined deductions which arise from an asset can only be offset against future profits from that same asset.

[Section DG 17(1) to (5) as inserted by s. 30(1) of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013* and the *Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill* page 67.]

SECTION VII: QUARANTINED EXPENDITURE TREATMENT FOR MIXED-USE ASSET OWNERS

<p>(5) Quarantined losses available where asset replaced</p>	<p>(5) Quarantined losses available where asset replaced</p> <p>A quarantined amount related to an asset may be used in relation to another asset of the person – see the <i>Officials’ Report</i> page 33 - if:</p> <ul style="list-style-type: none"> (a) The first asset is damaged, destroyed or lost, and is no longer held by the person; and (b) A second asset is required to replace the first asset; and (c) The two assets are identical or substantially the same. <p>Officials commented that where an asset is damaged, written off by the insurance company, and replaced with another asset, it would be reasonable for quarantined losses to continue to be available where the replacement asset is substantially identical.</p> <p>[Section DG 17(6) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i> and the <i>Officials’ Report to the Finance and Expenditure Committee on Submissions on the Bill</i> page 33.]</p>
<p>(6) Example in legislation of quarantined loss allocation</p>	<p>(6) Example in legislation of quarantined loss allocation</p> <p>In the following income year, David derives \$10,000 from renting his city apartment at market rates to a non-associate.</p> <p>David's total allowable expenditure, under sections DG 7, DG 8, and DG 11, is \$8,000.</p> <p>He also has expenditure of \$5,000 quarantined from the previous income year.</p> <p>David is able to deduct \$2,000 of that quarantined expenditure.</p> <p>The remaining \$3,000 continues to be quarantined and may be allowed as a deduction for a later income year.</p> <p>[Section DG 17 as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>

SECTION VIII: QUARANTINED EXPENDITURE TREATMENT FOR GROUP COMPANIES ETC.

<p>(1) When quarantining applies to group companies, corporate and non-corporate shareholders</p>	<p>(1) When quarantining applies to group companies, corporate and non-corporate shareholders</p> <p>The expenditure incurred of a group company, a corporate shareholder, and/or a non-corporate shareholder of a mixed-use asset owning company can be quarantined if:</p> <p>(a) The group company, corporate shareholder and/or non-corporate shareholder incurs expenditure in an income year for which a deduction is limited under the asset value exceeds debt value rules in s. DG 12 to DG 14; and</p> <p>(b) The amount of income derived for the income year from the use of an asset, other than an amount of exempt income, is <u>less than 2% of</u>:</p> <p>(i) For land, including an improvement to land, the amount given by the later of either its most recent capital value or annual value (as set by the relevant local authority) or its cost on acquisition (or market value, if the transaction involves an associated person):</p> <p>(ii) For other property to which this subpart applies, its adjusted tax value.</p> <p>[Section DG 18(1) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>
<p>(2) Sequential application of the quarantining rules</p>	<p>(2) Sequential application of the quarantining rules</p> <p>(1) <u>The first looping rule</u>: The quarantining rules are first applied to every group company until no group companies exist to which the quarantining rules can apply;</p> <p>(2) <u>The second looping rule</u>: The quarantining rules are then applied sequentially to:</p> <p>(a) First, to 1 or more of the following persons, none of which is a group company referred to in (1) above (ignoring the look-through rule in s. YC 4 that would attribute a company's shareholding to its own shareholders or anyone else, and ignoring any zero voting interests):</p> <p>(i) A person who is a shareholder in mixed-use asset owning company;</p> <p>(ii) A person who is a shareholder in a company that is part of the same group of companies as the mixed-use asset owning company and has a voting interest in the mixed-use asset owning company;</p> <p>(a) Secondly, a person who is a shareholder in a company referred in paragraph (a) above; and</p> <p>(b) So on, until no other person exists to whom the quarantining rules can apply.</p> <p>[Section DG 18(2) and (3) and s. DG 2(6) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>

SECTION VIII: QUARANTINED EXPENDITURE TREATMENT FOR GROUP COMPANIES ETC.

<p>(3) Calculation of amount of quarantined expenditure</p>	<p>(3) Calculation of amount of quarantined expenditure</p> <p>1. The amount of the person's excess expenditure for the income year, that is either quarantined, or remains quarantined, and is denied as deduction in the income year, is calculated as follows:</p> <p style="text-align: center;">Quarantined amount</p> <p style="text-align: center;">= [expenditure] - [outstanding profit balance]</p> <p>=</p> <div style="display: flex; align-items: center; justify-content: center; margin: 20px 0;"> <div style="display: flex; align-items: center; margin-right: 10px;"> <div style="border-left: 1px solid black; border-right: 1px solid black; padding: 5px; margin-right: 5px;"> <p style="text-align: center;">The person's deductions after apportionment under s.DG12 to DG14</p> </div> <p style="margin: 0 5px;">+</p> </div> <div style="display: flex; align-items: center; margin-right: 10px;"> <div style="border-left: 1px solid black; border-right: 1px solid black; padding: 5px; margin-right: 5px;"> <p style="text-align: center;">The person's quarantined amounts for earlier years not allocated to an income year</p> </div> </div> <div style="margin-right: 10px;"> <p style="margin: 0 5px;">-</p> </div> <div style="border-left: 1px solid black; border-right: 1px solid black; padding: 5px; margin-right: 5px;"> <p style="text-align: center;">For a group company : the outstanding profit balance in s.DG16(5) For a shareholder : the person's share of the outstanding profit balance in s.DG16(5) calculated using the formula in s.DG13(3) treating the outstanding profit balance as if it were the net asset balance i.e. : $\left(\begin{matrix} \text{outstanding profit} \\ \text{balance} \end{matrix} \right) \times \left(\begin{matrix} \text{Person's} \\ \text{interest} \end{matrix} \right)$</p> </div> </div>
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SECTION VIII: QUARANTINED EXPENDITURE TREATMENT FOR GROUP COMPANIES ETC.

<p>(4) Example in legislation of quarantining expenditure treatment for group companies, and corporate and non-corporate shareholders</p>	<p>(4) Example in legislation of quarantining expenditure treatment for group companies, and corporate and non-corporate shareholders</p> <p>Aircraft Ltd owns an aircraft to which the rules in this subpart apply; the income derived from the asset in the current year is less than 2% of the cost of the aircraft.</p> <p>The company has calculated an outstanding profit balance of \$12,000 after the application of s. DG 16.</p> <p>Aircraft is 100% owned by Parent Ltd, which has apportioned interest expenditure of \$5,000 calculated under s. DG 12.</p> <p>Parent has 2 equal shareholders, Alisa who has apportioned interest expenditure of \$8,000, and Hamish who has apportioned interest expenditure of \$1,000, both calculated under s. DG 14.</p> <p>Parent must apply s. DG 18 first, and is not required to quarantine any of its interest expenditure; the outstanding profit balance is reduced to \$7,000 (\$12,000 - \$5,000).</p> <p>Alisa's and Hamish's share of the outstanding profit balance is \$3,500 each (\$7,500 x 50%).</p> <p>Alisa must quarantine \$4,500 of interest expenditure (\$8,000 - \$3,500); Hamish is not required to quarantine any interest expenditure.</p> <p>[Section DG 18 as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Bill</i>.]</p>
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SECTION VIII: QUARANTINED EXPENDITURE TREATMENT FOR GROUP COMPANIES ETC.

<p>(5) When quarantined amounts can be allocated to group companies etc.</p>	<p>(5) When quarantined amounts can be allocated to group companies etc.</p> <p>A quarantined amount of a group company, a corporate shareholder, or a non-corporate shareholder can be allocated to a current year if:</p> <p>(a) The group company, corporate shareholder, or non-corporate shareholder has excess expenditure that has been quarantined in an earlier income year; and</p> <p>(b) An outstanding profit balance of a mixed-use asset owning company arising under s. DG 17(4) – see pages 30 - 31 above - is available for use by the group company, corporate shareholder, or non-corporate shareholder.</p> <p>[Section DG 19 as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>
<p>(6) Sequential application of the quarantined expenditure allocation rules</p>	<p>(6) Sequential application of the quarantined expenditure allocation rules</p> <p>The quarantined expenditure allocation rules are applied sequentially in the order set out in s. DG 17(2) and (3) until the outstanding profit balance is reduced to zero:</p> <p>(1) <u>The first looping rule:</u> The quarantined expenditure allocation rules are first applied to every group company until no group companies exist to which the quarantined expenditure allocation rules can apply;</p> <p>(2) <u>The second looping rule:</u> The quarantined expenditure allocation rules are then applied sequentially to:</p> <p>(a) First, to 1 or more of the following persons, none of which is a group company referred to in (1) above (ignoring the look-through rule in s. YC 4 that would attribute a company's shareholding to its own shareholders or anyone else, and ignoring any zero voting interests):</p> <p>(i) A person who is a shareholder in mixed-use asset owning company;</p> <p>(ii) A person who is a shareholder in a company that is part of the same group of companies as the mixed-use asset owning company and has a voting interest in the mixed-use asset owning company;</p> <p>(c) Secondly, a person who is a shareholder in a company referred in paragraph (a) above; and</p> <p>(d) So on, until no other person exists to whom the quarantined expenditure allocation rules can apply.</p> <p>[Section DG 19(2) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>

SECTION VIII: QUARANTINED EXPENDITURE TREATMENT FOR GROUP COMPANIES ETC.

(7) Deduction and allocation of previously quarantined expenditure to group companies etc.	<p>(7) Deduction and allocation of previously quarantined expenditure to group companies etc.</p> <p>1. The amount of previously quarantined expenditure that is quarantined that the person is allowed as a deduction for the current year must not exceed the lesser of:</p> <p>(a) The excess expenditure of the person that was quarantined in earlier income years; and</p> <p>(b) The amount – the current year excess - calculated as follows:</p> $\text{[Outstanding profit balance]} - \text{[expenditure]}$ $=$ <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="border: 1px solid black; padding: 5px; width: 60%;"> <p><i>For a group company :</i> the outstanding profit balance for the company for the current year under s.DG18(5) if applicable, otherwise under s.DG17(4)</p> <p><i>For a shareholder :</i> the person's share of the outstanding profit balance for the current year under s.DG18(5) if applicable, otherwise under s.DG17(4) calculated using the formula in s.DG13(3) treating the outstanding profit balance as if it were the net asset balance i.e.:</p> $\left(\begin{array}{l} \text{outstanding profit} \\ \text{balance} \end{array} \right) \times \left(\begin{array}{l} \text{Person's} \\ \text{interest} \end{array} \right)$ </td> <td style="border: 1px solid black; padding: 5px; width: 5%; text-align: center;">-</td> <td style="border: 1px solid black; padding: 5px; width: 35%;"> <p>The total deductions the person is allowed for the current year after apportionment under s.DG12 to DG14</p> </td> </tr> </table> <p>2. For the purposes of quarantined expenditure allocation, if the amount of the outstanding profit balance for the income year exceeds expenditure, the result is treated as zero.</p> <p>3. For the purposes determining the outstanding profit balance for the application of the quarantined expenditure allocation formula, the outstanding profit balance must be recalculated on each application, being reduced by an amount equal to the amount of any deduction for quarantined expenditure counted.</p> <p>[Section DG 19(3) to (6) as inserted by s. 30(1) of the Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013]</p>	<p><i>For a group company :</i> the outstanding profit balance for the company for the current year under s.DG18(5) if applicable, otherwise under s.DG17(4)</p> <p><i>For a shareholder :</i> the person's share of the outstanding profit balance for the current year under s.DG18(5) if applicable, otherwise under s.DG17(4) calculated using the formula in s.DG13(3) treating the outstanding profit balance as if it were the net asset balance i.e.:</p> $\left(\begin{array}{l} \text{outstanding profit} \\ \text{balance} \end{array} \right) \times \left(\begin{array}{l} \text{Person's} \\ \text{interest} \end{array} \right)$	-	<p>The total deductions the person is allowed for the current year after apportionment under s.DG12 to DG14</p>
<p><i>For a group company :</i> the outstanding profit balance for the company for the current year under s.DG18(5) if applicable, otherwise under s.DG17(4)</p> <p><i>For a shareholder :</i> the person's share of the outstanding profit balance for the current year under s.DG18(5) if applicable, otherwise under s.DG17(4) calculated using the formula in s.DG13(3) treating the outstanding profit balance as if it were the net asset balance i.e.:</p> $\left(\begin{array}{l} \text{outstanding profit} \\ \text{balance} \end{array} \right) \times \left(\begin{array}{l} \text{Person's} \\ \text{interest} \end{array} \right)$	-	<p>The total deductions the person is allowed for the current year after apportionment under s.DG12 to DG14</p>		

SECTION VIII: QUARANTINED EXPENDITURE TREATMENT FOR GROUP COMPANIES ETC.

<p>(8) Example in legislation of quarantining expenditure allocation for group companies, and corporate and non-corporate shareholders</p>	<p>(8) Example in legislation of quarantining expenditure allocation for group companies, and corporate and non-corporate shareholders</p> <p>In the following income year, Aircraft has calculated an outstanding profit balance of \$16,000 after the application of s. DG 18.</p> <p>Section DG 19 does not apply to Parent or Alisa because they have no previously quarantined interest expenditure.</p> <p>However, the section does apply to Hamish because he has \$4,500 of quarantined interest expenditure from the previous year.</p> <p>Hamish's current year apportioned interest expenditure is \$7,000, calculated under s. DG 14, and his share of the outstanding profit balance is \$8,000 (\$16,000 x 50%).</p> <p>Hamish is allowed a deduction for \$1,000 of previously quarantined expenditure (\$8,000 - \$7,000). His remaining quarantined expenditure is \$3,500 (\$4,500 - \$1,000).</p> <p>[Section DG 19 as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>
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SECTION IX: EXCLUSION FROM QUARANTINED EXPENDITURE TREATMENT

<p>(1) Exclusion from quarantined expenditure rules when income cannot be separately attributed</p>	<p>(1) Exclusion from quarantined expenditure rules when income cannot be separately attributed</p> <p>(1) The quarantined expenditure rules in sections DG 16 and DG 18 do not apply to the use of an asset for an income year when:</p> <p>(a) The person derives an amount of income for the income year from the use of the asset in a business activity; and</p> <p>(b) Because of the nature of the activity, an amount cannot be separately attributed to the use of the asset.</p> <p>(2) This exclusion does not apply if:</p> <p>(a) The person also uses the asset in deriving an amount of income that is separately attributable to the use of the asset; and</p> <p>(b) The use of the asset referred to in paragraph (a) is at least 80% of the total use of the asset both in the business activity referred to in (1) and as described in paragraph (a).</p> <p>[Section DG 20 as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>
<p>(2) Example in legislation of income that cannot be separately attributed</p>	<p>(2) Example in legislation of income that cannot be separately attributed</p> <p>Paul uses a helicopter on his farm to check stock for 50 hours in an income year, rents it out for 50 hours, and also uses it privately.</p> <p>While the income from the rental is clear, the income Paul derives in relation to the use of the helicopter in farming operations is not.</p> <p>The use of the helicopter falls outside the rules under the exclusion in s. DG 20(1), and does not meet the requirements for re-inclusion under s. DG 20(2) as the use of the helicopter to earn rental income is only 50% of the total income-earning use of the helicopter.</p> <p>Any loss attributable to the helicopter is not quarantined.</p> <p>[Section DG 20 as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>

SECTION X: OPTING OUT OF TREATMENT UNDER THE MIXED-USE ASSETS RULES

<p>(1) Income threshold for opting out of treatment under the mixed-use assets rules</p>	<p>(1) Ability to opt out of treatment under the mixed-use assets rules</p> <ol style="list-style-type: none"> 1. If the amount of income derived for an income year from the use of an asset is less than \$4,000, the person who has the asset may choose to treat the income as exempt income under s. CW 8B(2), under which income derived in respect of a use a mixed-use asset will be exempt if the person meets the “opting out” requirements of s. DG 21, and chooses to treat the income as exempt income under s. DG 21. 2. The threshold amount does not include an amount of income derived in relation to the private use of the asset as described in s. DG 4(1) – see pages 9 - 10 above – and consequently exempt under s. CW 8B(3). 3. If, in relation to the use of an asset in an income year, the person has an amount of quarantined expenditure for the income year, they may choose to treat the amount of income derived that gives rise to the quarantined expenditure as exempt income under s. CW 8B for the income year. 4. This rule does not apply when the person who has the asset is a company: such a person cannot opt out of treatment under the mixed-use assets rules. 5. Officials have stated that: <ol style="list-style-type: none"> (a) Asset owners with low levels of income would be likely to be in loss after the application of the apportionment rules, so the gross income threshold could be increased to \$4,000. (b) A provision similar to a net income threshold exists, which allows a taxpayer to opt out if a quarantined deduction arises – essentially if net income after applying the mixed use assets rules is nil or less and gross income is less than 2% of the asset’s value. (c) The revised income thresholds will make it easier for people to qualify for the opt-out thresholds because only market value income from non-associates will be counted: <ol style="list-style-type: none"> (i) Income from associated persons will be treated as exempt; and (ii) Income which is less than 80% of the market value of the use of the asset will be treated as exempt. (d) The opt-out rules have an unintended consequence when applied to assets owned by companies, which is that the disapplication of the mixed-use assets rules would allow a corporate group to claim all of its interest deductions. Therefore, the opt-out rules should be restricted to non-companies. <p>[Section DG 21(1) and (2) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i> and the <i>Officials’ Report to the Finance and Expenditure Committee on Submissions on the Bill</i> pages 33 and 70.]</p>
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SECTION X: OPTING OUT OF TREATMENT UNDER THE MIXED-USE ASSETS RULES

<p>(2) Consequences of opting out</p>	<p>(2) Consequences of opting out</p> <p>When a person who has an asset chooses under s. DG 21(1) or (2) to treat the income derived from the use of the asset as exempt income, any interest expenditure that must be apportioned under s. DG 9 (the general apportionment formula for mixed-use assets – see page 13 above) is treated as expenditure incurred in deriving exempt income.</p> <p>[Section DG 20(3) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>
<p>(3) Example in legislation relating to opting out</p>	<p>(3) Example in legislation relating to opting out</p> <p>Mike rents his bach out through the internet to a non-associate.</p> <p>The gross amount he receives for an income year is \$3,000.</p> <p>Mike can opt out of the rules in this subpart, which would mean that he would not be liable to tax on the amount, but would also not be entitled to claim any deductions in relation to the bach.</p> <p>[Section DG 20 as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>

SECTION XI: APPLICATION OF THE MIXED-USE ASSETS RULES TO PART YEARS

(1) Application of the mixed-use assets rules to part years	<p>(1) Application of the mixed-use assets rules to part years</p> <p>When the total income-earning use, private use, and non-use of an asset of a person relates to only part of an income year:</p> <ol style="list-style-type: none"> 1. <u>Non-use period</u>: For the purposes of s. DG 3(1)(b) – see page 6, the number of days is calculated using the formula: $\frac{\text{Days}}{365} \times 62$ 2. <u>Debt value when assets acquired during the year</u>: For the purposes of s. DG 11(9) – see page 19 onwards, if the company acquires the asset during the income year, the debt value is treated as the outstanding amount at the end of the income year. 3. <u>Debt value when assets disposed of during the year</u>: For the purposes of s. DG 11(9) – see page 19 onwards, if the company disposes of the asset during the income year, the debt value is treated as the outstanding amount at the start of the income year. 4. <u>Debt value when assets both acquired and disposed of during the year</u>: For the purposes of s. DG 11(9) – see page 19 onwards, if the company both acquires and disposes of the asset during the income year, the debt value is treated as the average of the outstanding amounts on the date on which the asset was acquired and the date of its disposal. 5. <u>Calculation of interest expenditure to be apportioned</u>: For the purposes of s. DG 11 to DG 14 – see page 19 onwards, when a mixed-use asset owning company acquires or disposes of an asset during an income year, the amount of interest expenditure that must be apportioned is calculated on a pro rata basis. 6. <u>2% threshold in quarantined expenditure rules</u>: For the purposes of the 2% threshold in the quarantined expenditure rules in s. DG 16(1)(b) – see page 28, the threshold is calculated using the formula: $\frac{\text{Days}}{365} \times 2\%$ 7. <u>Meaning of “days”</u>: In the above formulae, “days” is the number of days in the income year on which the person has the asset, and for the purposes of the calculation, s. DG 9(4) – see page 13 - (other measures such as nights, hours, etc.) similarly applies. <p>Officials noted that the proposals included rules which pro-rate thresholds where the asset is acquired or disposed of during the year. The rules needed to be amended to deal with situations when the asset is acquired and disposed of in the same year.</p> <p>[Section DG 22 as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i> and the <i>Officials’ Report to the Finance and Expenditure Committee on Submissions on the Bill</i> page 71.]</p>
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SECTION XII: RELATIONSHIP WITH OTHER PARTS OF THE ACT

<p>(1) Relationship with sections DB 5, DB 7, and DB 8</p>	<p>(1) Relationship with sections DB 5, DB 7, and DB 8</p> <p>The mixed-use assets rules override specific provisions relating to deductions for financing expenditure, in relation to expenditure that the mixed-use assets rules apply to:</p> <p>(a) Section DB 5 (deduction for expenditure incurred in borrowing money that is used as capital);</p> <p>(b) Section DB 7 (deduction for most companies for interest expenditure); and</p> <p>(c) Section DB 8 (deduction for companies for interest expenditure on money borrowed to acquire shares in another group company).</p> <p>Officials noted that the mixed-use assets rules override the provisions under which borrowing costs are deductible, but incorrectly refer to them as interest costs. This has been corrected.</p> <p>[Section DG 2(2) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i> and the <i>Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill</i> page 71.]</p>
<p>(2) Relationship with the entertainment expenditure rules in subpart DD</p>	<p>(2) Relationship with the entertainment expenditure rules in subpart DD</p> <p>The entertainment expenditure rules in subpart DD do not apply to expenditure incurred in relation to the private use of an asset to which the mixed-use assets rules apply.</p> <p>[Section DG 2(3) as inserted by s. 30(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>
<p>(3) Relationship with the FBT rules and dividend rules</p>	<p>(3) Relationship with the FBT rules and dividend rules</p> <p>No liability to pay fringe benefit tax arises from the private use of an asset to which the mixed-use assets rules apply.</p> <p>In circumstances where s. CX 17 (Benefits provided to employees who are shareholders or investors) applies to a company to which the mixed-use assets rules also apply, the company must choose to treat a non-cash benefit referred to in that section as a dividend.</p> <p>[Section DG 2(4) as inserted by s. 30(1) and s. CX 17(6) as inserted by s. 20(1) of the <i>Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013</i>]</p>

SECTION XII: RELATIONSHIP WITH OTHER PARTS OF THE ACT

<p>(4) Mixed-use assets rules and provision of accommodation</p>	<p>(4) Mixed-use assets rules and provision of accommodation</p> <p>Officials recommended that where the mixed-use assets rules apply, the provision of accommodation should not give rise to an income tax liability. This has not been included in the draft legislation</p> <p>Officials also suggested that in circumstances where the provision of accommodation gives rise to an income tax liability, the use should be treated as an income-earning day under the apportionment formula. This appears to be the treatment adopted.</p> <p><i>[Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill page 24.]</i></p>
<p>(5) Mixed-use assets rules and the deemed dividend rules</p>	<p>(5) Mixed-use assets rules and the deemed dividend rules</p> <p>Officials commented that the deemed dividend rules should apply where the mixed-use assets rules apply. They commented that:</p> <p>“A simple comparison can be made with a cash dividend. A cash dividend is not deductible to the company which pays it, but is income to an individual who receives it. Imputation credits may be available to meet the tax liability on that income. This is exactly the same result that would be achieved by having both the mixed-use asset and the deemed dividend rules apply to an asset.”</p> <p><i>[Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill page 24.]</i></p>