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WEEKLY COMMENT: FRIDAY 10 MAY 2024

1. The *Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Act 2024* (the "Multinational Tax Amendment Act 2024"), with a date of assent of 28 March 2024, contains a number of major amendments. This week I am looking at the changes to the interest deductibility rules for residential properties, changes to the rules concerning partitioning of land among co-owners and changes to rules concerning building depreciation.

Changes to the interest deductibility rules

2. With effect from 1 April 2025, Subpart DH, which contains the rules which limit the deductibility of interest on disallowed residential property, is being repealed.
3. In the meanwhile, with effect from 1 April 2024, s DH 8(2) has been amended so that the deduction denied for interest in DH 8(1) is limited to 20% for the period from 1 April 2024 to 31 March 2025.
4. The interest deduction denied for interposed residential property holders is similarly amended to 20% of the amount calculated under the pre-existing formula in s DH 8(3), for the year from 1 April 2024 to 31 March 2025.
5. New s DZ 24 provides a deduction for previously denied interest deductions if the proceeds from the disposal of residential property are taxable as follows:

   (a) If the proceeds are taxable under the 2-year bright-line test in s CB 6A, the previously denied interest deductions are treated as part of the cost of the property under s DB 23;

   (b) If the proceeds are taxable under another land tax provision, the denied interest deductions are allowed as a deduction in the income year the property is disposed of and are subject to allocation under Subpart EL (the residential property losses ring-fencing rules).

Partitioning of land among co-owners

6. The Platform Economy Amendment Act 2023 inserted a new s CW 3C(1), which provided that an amount a person derives from land is exempt income if they are a co-owner of the land and:

   (a) The land is disposed of by the person to themselves and other co-owners, but to no third parties by any co-owner; and

(b) As between the co-owners, the value of the land disposed of by them to each of themselves is proportionate to the value contributed by each co-owner for their acquisition of the land.

7. In addition, s CW 3C(2) was a de minimis provision which provided that if the person has the smallest proportion of the land as between co-owners and the land's value at the time of the disposal is not exactly proportionate to the acquisition value as between co-owners, income derived by the person is nevertheless exempt income if the difference between the actual disposal proportion and the proportion required by s CW 3C(1) for an exemption is less than 5%.

8. Inland Revenue commented in the Platform Economy TIB Item on page 124-125 that:

   (a) Taxpayers sometimes purchase land together as co-owners to pool resources, and it is not uncommon in this situation for the co-owners to then subdivide the land and allocate the subdivided parcels to each of the co-owners based on their ownership interests in the original parcel: this is known as partitioning;

   (b) Prior to the insertion of s CW 3C, an income tax liability could have arisen on partitioning even where there was no effective change in economic ownership or where the person would not have been taxed on the eventual sale of the property (for example, because it was their main home, or they held the property for longer than the bright-line period);

   (c) The amendment ensures that the allocation of subdivided land among the co-owners of the original undivided land in accordance with their original ownership percentages is exempt income;

   (d) If the allocated shares after the subdivision do not align with the co-ownership interests in the original parcel, the intention is that only the difference should not be exempt under CW 3C and be taxed where the bright-line test or other land sales rules apply: this is not currently provided for in the new legislation, but it is intended an amendment should be recommended for inclusion in the next available tax bill;

   (e) As far as the de minimis provision is concerned, if the difference exceeds 5% of the smallest co-owner's original share, the full difference should be taxed: this is not currently provided for in the new legislation, but it is intended an amendment should be recommended for inclusion in the next available tax bill;

   (f) The type of subdivision is irrelevant. For example, the proposed amendment applies to fee simple subdivisions as well as unit titles issued under the Unit Titles Act 2010;

   (g) The bright-line test continues to apply, and the bright-line acquisition date for the allocated subdivided parcels should be the bright-line acquisition date for the original undivided parcel of land;

   (h) The amendment has effect for partitions occurring on or after 27 March 2021, but for partitions occurring before 27 March 2021, Inland Revenue will not apply resources to identify non-compliance based on the current law interpretation.

9. Section CW 3C has been replaced, effective from 27 March 2021, by s 18 of the Multinational Tax Amendment Act 2024. New s CW 3C addresses the issues noted by Inland Revenue:

(a) Section CW 3C(1) provides that an amount that a person who is a co-owner of land derives from disposing of land to another co-owner on a partition or subdivision is exempt income if the person's proportion of the value of the land they receive on the partition or subdivision out of the total value of the land still held by persons who were co-owners, whether alone or jointly or in common with another person, is no less than 95% of their contribution to the cost of the land, including costs to subdivide, develop, and build on the land, as a proportion of the total cost;

(b) Section CW 3C(8) gives the meaning of "co-owner" , in relation to land, as including a company in which the person is a shareholder, a person acting in their personal capacity, or their capacity as a trustee of a trust, partner in a partnership, or owner of a look-through company, even if they became a co-owner of the land in a different one of those capacities;

(c) Section CW 3C(2) provides that if s CW 3C(1) does not apply, an amount that a person who is a co-owner of land derives from disposing of land to another co-owner on a partition or subdivision is exempt income to the extent given by the following formula:

Amount derived – (total land value x (acquisition proportion – end value proportion)).

(d) Sections CW 3C(3) to (7) define the items in the formula as follows:

(i) "Amount derived" is the amount a co-owner receives from the disposal of their interest in the land to another co-owner on a partition or subdivision;

(ii) "Total land value" is the total value of the land held by all persons who were co-owners, whether alone or jointly or in common with another person, at the end of the partition or subdivision;

(iii) "Acquisition proportion" is the person's contribution to the cost of the land, including costs to subdivide, develop, and build on the land, as a proportion of the total cost; and

(iv) "End value proportion" is the person's proportion of the value of the land they receive, whether alone or jointly or in common with another person, on the partition or subdivision out of the total value of the land still held by persons who were co-owners.

10. New s CB 15E applies when a person disposes of land acquired from a co-owner on a partition or subdivision, and derives income under s CB 10(2) (land disposed of within 10 years and association with a land dealer or developer at the time the land was acquired) or s CB 15(1) (land acquired from an associated person transferor who would have been taxed on the disposal) if, at the time the land that was partitioned or subdivided was originally acquired, the person was not associated with a person that carried on a business of developing land or dividing land into lots, and provides that:

(a) Under s CB 15E(2), the amount of income the person derives under s CB 10(2) or CB 15(1) is exempt income if the person's "end value proportion" under s CW 3C, is no more than 105% of their "acquisition proportion" under s CW 3C;

(b) Under s CB 15E(3), if the exemption in s CB 15E(2) does not apply, the income derived under s CB 10(2) or s CB 15(1) is reduced by an amount calculated as:

Amount derived x (acquisition proportion – end value proportion);

(c) Section CB 15E(4) to (7) define the terms in the formula as follows:

   (i) "Amount derived" is the amount the person derives from disposing of the land; and

   (ii) The other terms are defined as for s CW 3C (see paragraph 6 onwards above);

(d) To the extent that the exemptions in either s CB 15E(2) or (3) apply to a person who is a member of a wholly-owned group of companies or a consolidated group, the amount is not income under s CV 1 or s CV 2.

Building depreciation

11. Effective from the 2024-25 income year onwards, s EE 31 has been amended, by s 55 of the Multinational Tax Amendment Act 2024, so as to reinstate the 0% depreciation rate for commercial buildings with an estimated useful life of 50 years or more.

12. Inland Revenue has stated in the Commentary to the Amendment Paper that the estimated useful life of a building is determined on a "whole-of-life" rather than remaining-life basis. For example, if a person purchases a secondhand item with an estimated useful life of 50 years, its estimated useful life will still be 50 years, regardless of how old the item actually is. The 0% rate would apply to buildings regardless of when the building was acquired.

13. Inland Revenue also notes that buildings will still be depreciable property, but with a 0% annual depreciation rate. This means that the other depreciation provisions, such as those providing for depreciation recovery still apply.

14. Section EE 35(2) states that a special rate may not be set for an item of excluded depreciable property, an item of special excluded depreciable property, or a building. Inland Revenue notes that the Commissioner would continue to be able to set provisional depreciation rates for buildings with an estimated useful life of less than 50 years.

15. The definition of "building" in s YA 1 has been replaced by s 118(13) of the Multinational Tax Amendment Act 2024. The new definition states that "building" in subpart EE, includes part of a building, to the extent to which it is a unit in a unit title development under the Unit Titles Act 2010, but, in subparts EE and EZ, does not include:

    (a) A grandparented structure;

    (b) Commercial fit-out, except for commercial fit-out acquired as part of a building in the 2010–11 or an earlier income year for which the person has never had any deductions under any provisions other than sections DB 65, as in force before its repeal, and DB 65B (inserted by the Multinational Tax Amendment Act 2024 – see paragraph 20 onwards below).

16. Inland Revenue notes that the Commissioner's view on the meaning of "building" is set out in interpretation statement IS 22/04 Claiming depreciation on buildings, *Tax Information Bulletin*, Vol. 34, No. 8, September 2022.

17. A "grandparented structure" is defined, under the replacement definition in s 118(27) of the Multinational Tax Amendment Act 2024, as meaning, for a person, any item on the following list if the person acquired the item, or entered into a binding contract for the purchase or construction of the item, on or before 30 July 2009:

(a) Barns, including barns (drying);

(b) Carparks (buildings);

(c) Chemical works;

(d) Fertiliser works;

(e) Powder drying buildings;

(f) Site huts.

18. Inland Revenue notes that the grandparented structure rules were inadvertently repealed when building depreciation was re-introduced, so the rules are being reinstated with retrospective effect from 1 April 2020. Therefore, grandparented structures are excluded from the definition of "building" and s EE 37(3) has been amended so that improvements to grandparented structures made after 30 July 2009 are treated as separate depreciable property.

19. Commercial fit-out is excluded from the definition of building, except for commercial fit-out that was acquired as part of a building in 2010-11 or an earlier income year and for which there had been no deductions other than under the previous s DB 65 (which provided a implied deduction based on 15% of the building's tax book value).

20. A new s DB 65B, applying for the 2024-25 and later income years, provides a deduction at 1.5% per annum on for commercial fit-out acquired as part of a building in 2010-11 or an earlier income year and for which there had been no deductions other than under the previous s DB 65, subject to the following conditions:

    (a) The deductible base of the commercial fit-out, referred to as the "starting pool", is 15% of the building's adjusted tax value at the end of the 2010-11 income year, reduced by the adjusted tax value as at the end of the 2010-11 income year, of items of commercial fit-out acquired after the building was acquired and for which there had been depreciation deductions taken;

    (b) The deduction cannot exceed the remaining starting pool after deducting the sum of:

        (i) Deductions allowed under s DB 65B;

        (ii) Any deductions taken under the previous s DB 65; and

        (iii) Imputed deductions deemed to have been taken at 1.5% per annum over the previous 4 years, from 2020-21 to 2023-24, during which commercial buildings were depreciable (which Inland Revenue states is a proxy for the depreciation deductions relating to the fit-out that have been taken as part of depreciating the whole building during this period).

21. The deductions taken under s DB 65B will be included as depreciation for the purposes of calculating depreciation recovery income upon the sale of the building, similar to treatment of deduction s taken under the previous s DB 65. Section EE 60(1) has been amended to reflect this.

22. The definition of "special excluded depreciable property" has been reinstated in s EE 67, applying for the 2024-25 and later income years. Special excluded depreciable property:

(a) Means all buildings that are not items specified in Schedule 39;

(b) Is not "excluded depreciable property", under the amended definition in s EE 64, meaning that buildings that are special excluded depreciable property cannot be depreciated at the applicable 1992-93 rate, which applies to excluded depreciable property;

(c) Are not items listed in Schedule 39, which lists a number of building-type structures, which remain depreciable (Inland Revenue notes that these are buildings that would not be expected to be long-life buildings and should not be subject to the 0% rate).

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