Trustpower Test Case on Tax Deductions for Project Costs

The Supreme Court has unanimously dismissed an appeal by Trustpower Ltd ("Trustpower") in a multi-million dollar tax dispute with the Commissioner of Inland Revenue:

***Trustpower Ltd v C of IR* (No 2) [2016] NZSC 91, 27 July 2016.**

Trustpower was a generator and retailer of electricity. It generated (by hydro or wind) about half of the electricity it sold and bought the rest on the electricity market from other generators. Trustpower's business income was derived from its retail sales.

Trustpower incurred expenditure in the 2006, 2007 and 2008 tax years in taking preliminary steps and then applying for an obtaining various consents under the Resource Management Act 1991 in respect of four possible future new generation projects in the South Island.

The company considered that $17.7 million of spending on resource consent applications amounted to "feasibility expenditure" and were therefore immediately deductible. But the IRD had disallowed the deductions, arguing the consents were intangible assets and the spending should therefore be capitalised and depreciated over time.

The High Court had found in favour of Trustpower, but in June 2015 the Court of Appeal sided with IRD. In March this year the case was taken to the Supreme Court, and in a decision released on 27 July 2016 the country's top court has unanimously found in favour of the IRD. The Court found:

1. The expenditure on obtaining resource consents in this case was directly related to specific projects that would be on capital account if they came to fruition. The projects could not proceed without resource consents. Obtaining the consents therefore represented tangible progress towards their completion. The expenditure was therefore on capital account and not deductible.

2. Expenditure associated with early stage feasibility assessments regarding capital assets may be revenue expenditure and therefore deductible. Such assessments may be appropriately categorised as a normal incident of business. Expenditure which is not directed towards a specific project or which was so preliminary as not to be directed towards the advancement of such a project was likely to be on revenue account.

3. The capital/revenue issue was not controlled by the commitment approach. For this reason, a conclusion that the resource consents were stand-alone capital assets was not a necessary pre-condition to the application of the capital limitation.

4. The commitment approach did not provide a logical and principled explanation for why some expenditure was on capital account even though wasted and other expenditure which was identical, other than it was successful, should be on revenue account. There being no practical utility in the commitment approach, the indeterminacy associated with it would introduce complications to this area of the law which would serve no useful purpose and were therefore unnecessary. The subjectivity which was implicit in the commitment approach would also give rise to some practical problems.

5. Although section DB 19 of the Income Tax Act 2007 was not in force during the tax years in issue in this case, the current position is that section DB 19 now addresses, albeit not completely, the "black hole" problem with expenditure on resource consents and, should Trustpower surrender the resource consents, a deduction in relation to those which are time limited will be available.

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