

# Up close with the new lease incentive tax

Late last week, the IRD issued a statement proposing to tax lease inducement payments and other payments in relation to interest in land.

The announcement, which reverses a 14-year-old Privy Council decision, proposed that the change be applied retrospectively from last week once legislation has been passed by Parliament.

We commented on the retrospectivity.<sup>1</sup> This Brief Counsel considers the substance of the proposal.

## What does the statement apply to?

Lease inducement payments, and inducements to acquire other interests in land will now be taxable. Previously, these payments were confirmed to be non-taxable to the recipient by the Privy Council.<sup>2</sup>

The range of payments caught is wide. It would include any payment derived by a person in connection with an "arrangement" that grants an estate or interest in land. This includes easements and licences.

An "arrangement" is something less than a contract, and can include informal plans or understandings. The amount does not need to be paid by the landowner or received by the person being granted the interest in land. It can include taxpayers related to or associated with either party.

The IRD has indicated that it intends to exempt the sale of land and sale and lease-back transactions from the new rule. But leases with an option to purchase as well as assignments or extensions of leases will be captured.

## Timing of the tax payments

Tax would not have to be paid up front. The IRD's suggested approach would be to tax the recipient of a lease inducement payment in one of two ways:

1. spreading the income from the date received to the end of the lease, or to the first rent review date, or
2. spreading the income over a fixed term (for example, if a landlord was to receive a lease premium it can spread it over six years).

Other amounts offered as an incentive to enter into a lease are also proposed to be taxed. These include a contribution to costs of relocation, covering the tenant's rent or break costs with an old lease, or an interest-free loan. Contributions to fit-out were already made taxable in 2010.

## When does the statement apply?

The proposal requires legislative amendment, and the IRD intends to introduce this legislation later this year. However, the amendment will apply retrospectively to an arrangement entered into, on, or after the date the proposal was released (26 July), regardless of when the actual date of payment is.

## Chapman Tripp commentary

The logic of the proposal should require the IRD to make other changes to the tax legislation which it has not yet considered.

For example, if all lease inducement payments will be taxable to tenants, then all landlords should be entitled to a deduction for making such a payment. Currently, where the lease constitutes a capital asset for the landlord, no such deduction is available.

Costs (including break fees) that are incurred by the tenant for cancelling a lease early have a similar asymmetry to the one identified by the IRD. If the IRD is proposing to reverse the asymmetry with inducement fees, it should be consistent and reverse the

asymmetry with a break fee payable in respect of the same lease, not merely attack the asymmetry that is revenue-negative.

It remains to be seen how imposing a tax of 28% on lease incentives will affect the ability of landlords in Christchurch to incentivise tenants to move back to the CBD.

The proposed effective date and the short consultation time mean that it is difficult to resolve these issues. Please talk to us about how we can assist during this period.

## Footnotes

1. <http://www.chapmantripp.com/publications/Pages/IRD-channels-Muldoon-on-lease-inducement-payments.aspx>
2. *Watties v Commissioner of Inland Revenue* (1997) 18 NZTC 13,297



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