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Rory Noorland
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By email: rory@cooperaitken.co.nz

Dear Rory

Interpretation Statement – Farmhouse expenditure

Thank you for your submission on the above draft item. We appreciate all the submissions received and thank you for the time and effort you spent in preparing your written submission.

It was also very helpful to talk to you and discuss your submission with you. After careful consideration of all the submissions received, we have now finalised the ruling. We enclose a copy of the final ruling, for your reference.

Overview of changes

In response to the submissions received, we made a number of changes to the Interpretation Statement. The main changes are:

- An increase in the automatic deduction for Type 1 farmhouse expenses from 15% to 20%.
- A 100% rates deduction for Type 1 farmers.
- Further guidance and more examples on how to distinguish between Type 1 and Type 2 farmers.

Response to your submissions

We note your general agreement with our proposal of distinguishing between Type 1 and Type 2 taxpayers based on a 20% threshold based on the cost/value of the farmhouse compared to the farm.

Submission 1: Establishing the cost of farm for the Type Test

A number of submitters requested further guidance to differentiate between Type 1 and Type 2 farms. Accordingly, we have added some additional guidance to the Interpretation Statement and 2 new examples.

Submitters wanted us to be clearer about when to use the farm/farmhouse values and when to use the costs to distinguish between Type 1 and Type 2 farms. Our preferred method is to use the values of the farm and farmhouse. However, to reduce compliance costs we decided to also accept the respective costs of the farm and farmhouse. In hindsight, it was probably unhelpful to characterise the cost and value tests as being different in the Interpretation Statement. They are both ultimately concerned with providing a reasonable approximation and comparison of the respective values of the farm and farmhouse at a particular point in time.

In an effort to be as clear as possible the Interpretation Statement has been changed to require that the respective values of the farm and farmhouse are used. However, the Interpretation Statement also allows the relative costs of the farm and farmhouse to be used as a reliable approximation of value at a particular point in time. The examples now also show more clearly show the choices farmers have in valuing the farm and farmhouse, including whether to use cost as an approximation of value.

You also raised the issue of whether rateable values could be used for determining the value of the farming property. This is now addressed in the guidance and in the new examples. Although useful, rateable value is not a complete answer to the issue of valuation because of the difficulty in separating the farmhouse out from other "improvements". During the consultation process we received a number of rates notices that had a single figure for improvements and it was not possible to identify the value of the farmhouse from other improvements. However, we accept that in some instances the rateable value will be a reasonable estimate of the value of the whole farm.

Submission 2: Actual business use for a Type 2 farm

You supported Type 2 farmers having to establish actual business use of the farmhouse. Since consultation, the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 has been passed. Section 71 inserts a new s DB 18AA in the Income Tax Act 2007 which provides a simplified home office calculation. This might be useful for Type 2 farmers that have a dedicated home office and we have noted this in the Interpretation Statement.

Submission 3: 15% minimum for Type 1 farm

Most submitters considered that an automatic deduction for business use of the farmhouse of 15% of the farmhouse costs was too low. Sufficient justification was provided for us to also conclude that 15% was too low. The 15% figure was based on a time and space calculation based on a home office type situation. From the additional information we received we believe that we underestimated both the time and space elements. We also underestimated how many Type 1 farmers have employees using the farmhouse.

Based on the information available to the Commissioner and submissions received we consider that a 20% business use deduction will be more reasonable for most farmers. We appreciate that some farmers might still consider this figure is too low. Accordingly, there remains the ability for farmers to undertake their own calculation should they be able to justify a higher deduction.

Submission 4: Rates apportionment

We agree with your submission that a 100% rates deduction should be retained for Type 1 farmers. As discussed during the consultation process, we received a number of rates notices and now better understand the difficulties of dissecting and apportioning rates.

We consider that compliance costs may outweigh any tax benefit so have taken a practical approach (similar to interest deductions) of allowing a 100% deduction for Type 1 farmers.

Submission 5: Telephone rental

Submissions on this point were mixed with some (including you) supporting a 50% deduction so that farmers are treated the same as other taxpayers. Others said a 100% deduction was justified because of poor cell phone coverage or health and safety requirements or because rural internet providers require you to have a fixed landline. While we appreciate these arguments, we have retained the 50% deduction for fixed telephone lines. However, 50% is only the starting point and more can be claimed if it can be substantiated.

The policy of a 50% deduction for fixed telephone lines is something that the Commissioner may revisit. As technology moves on there are some questions about whether the existing policies are still appropriate. There may be further guidance on this issue in the future.

Once again, thank you for your comments. We appreciate your input on this item.

Yours sincerely

A handwritten signature in blue ink that reads "Grant Haley".

Grant Haley
Manager, Public Rulings