14 December 2016

Team Manager, Technical Services
Office of the Chief Tax Counsel
National Office
Inland Revenue Department
PO Box 2198
Wellington

Dear Sir/Madam

CooperAitken Submission on QWB00082: Income tax – deductibility of farmhouse expenses

CooperAitken is pleased to make a submission on the draft interpretation statement QWB00082: Income tax – deductibility of farmhouse expenses.

General comments

In general we welcome the Commissioner's review of deductibility of farmhouse expenses and in doing so replacing historic Inland Revenue statements, some dating back to 1964, with an updated view.

We agree with the proposed two tier system and resulting treatment of expenditure for each type of farm. We also agree with the differentiation being based on the cost of the farmhouse compared to the total cost of the farm and agree with the proposed 20% threshold to be considered a Type 1 farm.

Specific comments

Submission 1: Establishing cost of farm for the Type test

We recommend allowing a simpler approach for establishing the cost of the farmhouse and farm by clarifying whether the use of the rateable valuation to determine the percentage is considered a reasonable estimate.

Comment

In the case of farms that have been owned for many decades the cost of an updated farmhouse would be ascertainable but would require the significant expense of a valuation to ascertain the value of the land. In many circumstances the rateable value should provide sufficient justification that a farm meets the criteria of a Type 1 farm.

The use of a registered valuation should only be considered necessary for situations where the 20% calculation is border line when applying the rateable valuation approach. It would only be those taxpayers that would clearly benefit from the expense that would then undertake the valuation exercise.

Submission 2: Actual business use for a Type 2 farm

We support the requirement of a Type 2 farm to establish the actual business use of the farm house to determine the portion of the farmhouse costs that are deductible.

Comment

As noted this is in line with the requirements of non-farming commercial clients to perform a "home office" calculation to determine the business portion of otherwise private expenditure.

Submission 3: Interest and Type 1 farm

CooperAitken supports retaining the 100% deduction of interest for Type 1 farms without the need for any apportionment.

Comment

Practically the apportionment of interest in relation to the farm house would be difficult to calculate and in many instances immaterial.

Submission 4: 15% minimum for Type 1 farm

We submit that the minimum rate remain at 25%.

Comment

We are concerned that the basis of the minimum deduction of 15%, rather than the previously allowable deduction of 25%, has failed to take into account the practical realities of modern farming practices.

It has been identified that there are a number of different activities occurring within a farmhouse that are considered business activities. We do not believe the 15% minimum takes into account the full range of activities that involves the farmhouse in a typical farming operation.

There has been a significant change in the complexity and regulatory requirements of running a farming business since the original 25% deduction was introduced in the 1960's. The amount of 'off the land' work that is required is significant and the place this work will occur, in the majority of farming operations, is the farmhouse.

Some of the more recent changes impacting the role of a farmer include:

- Health and Safety management
- Health and Safety meetings
- NAIT and livestock tracking
- Detailed records of the genetics for the herd

- Increased staff numbers has resulted in extensive HR requirements including managing rosters and minimum wage compliance
- Management of environmental issues and compliance with regulation
- The need for far greater governance and the involvement of advisors
- Significant technological changes including administration and round the clock on farm monitoring
- The safe storage of records, firearms and hazardous materials

The setting of the minimum, if truly to mitigate compliance costs should be set at a rate that reflects the average or typical farming operation and does not unfairly punish the taxpayer for applying the minimum percentage for the purposes of simplicity.

Comparisons have been drawn between the farmhouse deduction and the home office deduction available to commercial taxpayers. Though similar, the comparison does not take into account the level of integration between the farmhouse and the farming enterprise. In many commercial situations a home office for a commercial taxpayer is an adjunct to their business and generally does not have the same level of integration that a farmhouse does.

It should be noted that use of the farmhouse is virtually seven days a week. For farmers the house, though providing shelter, is integrally ingrained in the life of a farmer. Unlike many other tax payers, returning 'home' for the day does not mean that the working day has ended.

In actual practice the farm house is the epicentre of the farm. Further to the changes impacting the role of a farmer noted above the following activities are also carried out from the farm house:

- Feeding of staff and preparation of meals
- Conducting team meetings
- An evacuation point and is also often the check in point for Health and Safety purposes.
- Meeting with advisors such as bank managers, accountants and farm advisors
- Farm finance administration such as accounts payable, GST returns etc.
- Farm management such as pasture plans and stock management.
- Storage of farm equipment and business assets
- Washing of staff clothing overalls etc.
- At times farm equipment will be connected to the house electricity supply, electric fences, water pumps etc.

Typically the areas of the farmhouse that are used, some more intensively than others, include:

- Kitchen
- Dining areas
- Laundry
- Garage
- Dedicated office spaces
- Lounge areas

For these reasons we submit that the minimum percentage be retained at 25% for a Type 1 farm.

Submission 5: Rates apportionment

We submit that the requirement of a Type 1 farm to apportion rates as proposed is removed and instead a 100% deduction for rates, in line with interest deductions, is allowed.

We support the apportionment approach for Type 2 farms in relation to rates.

Comment

A more practical approach and in line with reducing compliance costs would be to allow the 100% deduction for Type 1 farms of rates in the same manner as interest deductibility. The amount of increased tax collected from the apportionment of rates for Type 1 farms would be outweighed by the compliance cost for the taxpayer in analysing the rates invoices. The compliance cost would be extenuated in situations where there are multiple titles included in one rates notice rather than separate notices being issued as suggested in the exposure draft.

There will also be differing outcomes depending on the way that a farm has been acquired. Where a farm has been acquired as one lot, rather than two or more lots (one of which contains the farmhouse), there could be a reduced deduction available.

Although the difference may be small in many instances the taxpayer should have equal treatment under each scenario.

Submission 6: Telephone rental

We support the proposal that fixed line charges be claimed at the rate of 50% of the cost for non-dedicated phone lines.

Comment

This is a fair and reasonable approach to apportioning a cost that has joint use for personal and business purposes.

Yours faithfully
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