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Distribution Networks
C/- Deputy Commissioner, Policy and Regulatory Stewardship
Inland Revenue Department
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Submission on tax treatment of expenditure on distribution networks, a tax policy consultation document

Dear Deputy Commissioner

The Electricity Networks Association (ENA) appreciates the opportunity to make a submission on the Commissioner's consultation on "[Tax treatment of expenditure on distribution networks](#)" (the consultation document).

ENA is helping deliver a low-carbon future for New Zealanders — a future based on reliable, safe and affordable electricity networks. We represent all [27 lines companies](#) which operate the poles and wires delivering electricity to every region across New Zealand. We note that the views in this letter represent the best attempt within time available to align views of all ENA members. However, some might express individual views through separate submissions.

1. Summary of ENA Submission:

- While retrospective legislation should generally be avoided, we support the certainty that would be provided for the majority of members who have taken a tax position based on the "component items approach". We also expect that this approach will be welcomed by the other distribution network industries (including gas, water and telecommunications) who have previously adopted the component items approach.
- However, if the consultation document is implemented in its current form, members which have adopted the technically-correct "network approach" (**Affected Lines Companies**) will be

faced with a change in cashflows going forward, and with uncertainty, in respect of their historic tax positions.

- Therefore, ENA submits that:
 1. A grandparenting position should be included so that all past tax positions (both the component items and network approaches) are deemed to be accepted and protected from retrospective scrutiny.
 2. If implemented, the change to disallow the network approach should apply on a prospective basis from the start of the 2025 income year to allow Affected Lines Companies time to replan their cashflows and adjust their systems.
- Tax Policy officials (**Officials**) have determined that, in their view, the component items approach is the most practical way of depreciating distribution networks given the current approach taken by the majority of members. However, in our view Officials have not properly considered the broader costs and benefits of the two approaches.
- The consultation document provides no indication of how the component items approach would be implemented or the design of any legislative amendments. This makes it impossible for lines companies to know whether any amendments might affect them, and raises the possibility of those lines companies being subject to unintended compliance costs and other adverse consequences.
- The consultation document creates uncertainty from a financial reporting perspective.
- Therefore, ENA submits that Officials should:
 3. Give consideration to the costs and benefits with the two approaches.
 4. Consult with all lines companies (not just those that have applied the network approach) on the design and drafting of any amendments to implement the consultation document proposals, to ensure that amendments do not produce unintended consequences.
 5. Ensure that clarity is provided in a timely manner on the final form of the proposed legislative changes to reduce the financial reporting impact for all lines companies.

2. Retrospective amendment

It is a long-standing common law presumption that legislation does not apply retrospectively. In New Zealand, this is codified by s 12 of the Legislation Act 2019 (previously s 7 of the Interpretation Act 1999). Additionally, the Legislation Design and Advisory Committee (**LDAC**) which advises government departments and the Attorney-General on legislation has stated that legislation should have prospective, not retrospective, effect.

While we accept that Parliament has the ability to enact retrospective legislation and LDAC notes that it may be appropriate in limited circumstances in relation to tax law, we submit that it should do so only having carefully considered all potential consequences to all distribution networks and enacted appropriate savings or transitional provisions to address their particular circumstances in a manner that does not unfairly impact them. Not doing so would be out of step with the responsibility of Ministers and Officials to protect the integrity of the tax system.

While the proposed retrospective amendments will provide certainty to lines companies which have taken the component items approach on their historical position and therefore may be a justified use

of retrospective legislation, it will result in Affected Lines Companies being deemed, retrospectively, to have taken an incorrect tax position.

We therefore submit that, if the conclusion is to move to a component items approach with retrospective effect, a savings provision should be included so that Affected Lines Companies have their prior tax positions protected from Inland Revenue scrutiny, and any change to move Affected Lines Companies to the component items approach should be at a future date, the start of the 2025 income year. This delay in implementation will provide Affected Lines Companies with the time to update their current accounting systems and ensure that the correct position is reached.

3. Cost benefit analysis

Officials should give further consideration to costs and benefits associated with the component items and network approaches before deciding on the final form of any legislative changes. Some of the factors that may need to be considered are:

- Given the evolving nature of distribution networks and responsibility placed on lines companies to ensure that their networks meet specific, reliability criteria, there may be a wider benefit in allowing our members (as well as other industries potentially impacted) an option to take an immediate deduction for repairs and maintenance expenditure under the network approach. As our members are subject to the Commerce Commission's regulatory framework which limits their ability to generate excess profits, the network approach would afford a timing benefit enabling investment into lifeline utility services.
- Despite the consultation document recognising that the position adopted by the Affected Lines Companies has been correct for the last 30 years, Affected Lines Companies may now need to find funding for the tax bill that will arise as a result of the proposed changes. This cash shortfall will not have been included in the Affected Companies' cashflow forecasting and supports a delayed implementation date for the Affected Lines Companies to the start of the 2025 income year.
- The consultation document provides no clarity as to what additional funding will be required from a cash-flow perspective. In particular:
 - It is at the Commissioner's discretion to decide whether or not to amend the tax positions for any non-time barred tax returns that, on enactment, will be deemed incorrect. Affected Companies should not have to wait until these years become time-barred to gain certainty on what their cash-flow requirements are.
 - The consultation document does not provide sufficient detail on how the Affected Lines Companies should determine their tax position for the non-time barred years. Presumably, if the Affected Lines Companies have (now incorrectly) deducted repairs and maintenance expenditure in prior (time-barred) years, the (restated) written down value would not be increased for that repairs and maintenance expenditure previously claimed.

4. Consultation document provides no indication of how amendments to reflect the component items approach would be implemented

The consultation document was prompted by a question the Tax Counsel's Office considered concerning the relevant asset for the purposes of determining the deductibility of repairs and maintenance expenditure, and the view that the correct application of two court decisions (both over 20 years old) might allow a greater level of deductibility than Officials now think appropriate. The question of the relevant asset for depreciation and repairs and maintenance purposes and the

subsequent boundary between deductible repairs and maintenance, and improvements which must be capitalised and depreciated, involves questions of judgement and degree. Attempting to alter that boundary by prescriptive legislation is likely to be difficult, and risks having unintended consequences, such as increased compliance costs, or overreach resulting in appropriate deductions for repairs and maintenance costs being disallowed.

The consultation document does not describe the form any legislative amendments might take, or include any discussion of how such unintended consequences are avoided or minimised. This makes it difficult for lines companies (in particular those who have not adopted the network approach in respect of repairs and maintenance deductions) to know whether they may be affected by the proposals and, if so, how. This in turn limits the utility of the consultation document as a vehicle for proper consultation on what the impact of the proposals might be.

This lack of clarity also impacts on the ability of lines companies to prepare financial statements as it states that the approach that the majority of lines companies have taken is incorrect. But it does not provide the detail as to how Inland Revenue proposes to amend the legislation to make this position subsequently correct. This lack of certainty is less than ideal from a financial reporting perspective.

The consultation document states, at paragraphs 1.6 and 1.7:

The proposed legislative amendments are likely to have no material impacts on owners of distribution networks. The proposed amendments simply confirm that the component approach is the correct approach and thus retains that longstanding practice, which has been, for the most part, consistently applied by owners of distribution networks since 1 April 1993.

Officials seek your views on whether the proposed amendments are appropriately targeted and whether they could materially impact owners of distribution networks.

Without a sufficiently concrete description of what amendments Inland Revenue envisages, it is not possible to give a view on whether the consultation document proposals are appropriately targeted, whether they could materially impact distribution network owners which have taken a component approach, and how they will impact Affected Lines Companies.

We therefore submit that there needs to be a further round of consultation in which Officials explain the amendments proposed and the effect the amendments would have on Affected Lines Companies and on other lines companies (that have taken the component approach). We submit that if the amendments are to progress, Officials should explain how the detailed amendments proposed are justified by the problem definition (which, it appears, is the possibility of expenditure being classified as repairs and maintenance when in Inland Revenue's view it should be capitalised as a separate depreciable asset) and what steps will be taken to ensure that lines companies not within that problem definition will not be adversely affected by the amendments.

5. Comprehensive consultation

If Officials are intent on progressing these proposed amendments, they should be actively engaging with Affected Lines Companies to ensure that appropriate savings or transitional provisions are included in order to minimise associated compliance costs. Currently, the proposed consultation document unfairly penalises the Affected Lines Company for taking a tax position that the consultation document recognises is correct at law, and effectively creates a risk where the lines companies who utilise a network approach's recent income tax returns filed are now deemed to be incorrect.

In view of our comments in section 4 above, Officials should also consult with lines companies generally (not just the Affected Lines Companies) on the design and drafting of any amendments to implement the consultation document proposals, to ensure that the amendments do not produce

unintended consequences for them. This consultation needs to occur prior to draft legislation being introduced to the House. Once legislation has been introduced, there is often no time to address unintended consequences.

Thanks again for the opportunity to submit. If you'd like to discuss any of the matters raised, please contact me.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Graeme Peters', written in a cursive style.

Graeme Peters
Chief Executive
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