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Investing in a chance: TrustPower secures a rare taxpayer win in the courts

Campbell Rose and Matthew Scoltock

Introduction

Just when we had given up all hope that a thought-provoking black letter law tax issue would once again reach New Zealand's courts - and that taxpayers can win tax cases - Justice Andrews delivered the High Court's judgment in *TrustPower Ltd v Commissioner of Inland Revenue*[1] on 12 November 2013.

Her Honour confirmed that TrustPower's more than $17m of costs in applying for and obtaining resource consents, as part of a feasibility process, were deductible and not to be treated as capital in nature. In doing so Justice Andrews noted it was "artificial" to regard the consents as assets in their own right (as the Commissioner had argued), but her finding does appear to be heavily grounded in the particular facts of the case.

The commercial setting

Generating roughly half of the electricity that it distributes, TrustPower has in place a "development pipeline" of wind and hydro electricity generation projects at varying stages of feasibility assessment. The development pipeline enables TrustPower to decide whether or not, at any given time, it is best placed to "build" generation capacity or "buy" electricity for sale in the retail market.

Without any guarantee that a potential generation project will proceed to a finished product, TrustPower's development pipeline provides a means to explore the viability of electricity generation or – as one of TrustPower's witnesses put it - to "invest in a chance".

TrustPower uses a three-step process in assessing the feasibility of potential electricity generation projects. The consent aspect of the feasibility process arises after potential site selection but prior to design/costing, and before business case preparation. Being in the development pipeline does not automatically mean that a potential project will ultimately be constructed.

[1] CIV 2011-404-007140, [2013] NZHC 2970 (TrustPower).

The issues

Between 2005 and 2007, TrustPower incurred costs of around $17.7million in applying for, and obtaining, resource consents in respect of four potential projects in the development pipeline that never proceeded.

In TrustPower's view, these expenses were ordinary operating costs in the nature of feasibility expenditure, and therefore deductible. The Commissioner considered that the consents were stand-alone/separate assets, and were capital in nature – so that the associated costs were non-deductible.

The Court was faced with two key issues:

- Were the resource consents "stand-alone" assets for the purposes of the capital/revenue analysis?
- If so, were they assets that were capital or revenue in nature?

The disputes/litigation process

It is evident that the disputes process in this case was somewhat frustrating. Despite TrustPower having agreed to a time bar waiver, the Adjudication Unit was unable to issue its decision in time, meaning that an assessment was issued and proceedings filed to keep the dispute "live". The Adjudication Unit issued its decision a little over two weeks after the extended time bar had expired.

It is also curious that the Adjudication Unit appeared unable to make a decision in respect of all the legal issues, and returned the dispute to the Service Delivery Group to make relevant adjustments resulting from the conclusions that the Unit had managed to make. If this was the cause for the delay, then some form of communication with TrustPower and the Commissioner may have facilitated a fully reasoned decision being issued by the Unit.

Anecdotally, we understand that (unsurprisingly) the discovery process was extensive, costly and time-consuming – bearing in mind that this was a capital/revenue case, where general anti-avoidance was not in issue. It is conceivable that tens of thousands of emails needed to be whittled down through the use of forensic tools that we have discussed in other **Tax Alerts**.

Finally, it is clear that the factual evidence provided on behalf of TrustPower by its engineers, its chair Dr Harker, and its General Manager of Generation, Mr Kedian, was instrumental to the Court's findings. The engineers had spent 10 years 'living and breathing' the development pipeline, and proved to be highly persuasive witnesses.

The general principles

At the outset her Honour noted the conceptual difficulty of capital/revenue issues, citing case law authority that the dichotomy is almost as satisfactorily decided by "the spin of a coin … as by an attempt to find reasons", "the principles are elusive", and that the area is an "intellectual minefield".

That said, Justice Andrews' thorough judgment traverses the established principles in considered detail. Her Honour ultimately focuses on the practical question of what the expenditure on the resource consents was calculated to effect from a practical and business perspective.

A "stand-alone" asset?

Although we understand that this issue did not warrant a great deal of analysis in the Adjudication Unit's findings, the case before the High Court largely turned on whether the resource consents were stand-alone assets. To answer that question, the Court looked to the nature of the consents, and specifically what they provided TrustPower with.

The Commissioner contended that the consents ought to be viewed as stand-alone assets, as they provided TrustPower with benefits both in and of themselves, and as part of a "package of rights". The Commissioner noted that the consents provided TrustPower with the ability to build now or defer construction, that they provided an effective block to competition, and that they could be sold for valuable consideration.

The Court, however, was not swayed by the Commissioner's argument. Justice Andrews preferred TrustPower's position: the resource consents were inseparable from the land to which they related; they were no more than one aspect of a "suite" of rights; the intrinsic value of the consents in blocking competition was "tenuous, at best", particularly because "the same wind will blow across the hill next to where TrustPower has resource consents"; and TrustPower was only ever interested in each site as a whole (of which the resource consents were a single component).

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For these reasons, her Honour found the Commissioner's submission that the resource consents were stand-alone assets to be "artificial" on the facts of the particular case before her. In this respect the factual evidence concerning the development pipeline was key; we do not consider that the *TrustPower* decision has necessarily established a general proposition capable of application across a number of different contexts.

The BP Australia[2] *indicia*

Despite finding in favour of TrustPower on the basis that the resource consents were not stand-alone assets, Justice Andrews went on to look in depth at "*the BP Australia indicia*" to determine (for "the sake of completeness") whether – if the resource consents were separate assets – they were capital or revenue in nature.

Again, her Honour preferred TrustPower's arguments. She found that "the need or occasion" that required expenditure on resource consents was to "advance projects along the development pipeline". Accordingly, the expenses had the same character as TrustPower's other operating costs. The expenditure on the resource consents was "recurrent in nature", as it formed part of a continual feasibility investigation. In this respect the factual finding that TrustPower had not committed to proceed with any of the projects was critical (i.e. the consents did not themselves relate to existing projects).

[2] BP Australia Ltd v Commissioner of Taxation for the Commonwealth of Australia [1966] AC 224 (PC) (BP Australia).

Although Justice Andrews found that resource consents provided an enduring benefit, the costs were clearly treated as revenue in accordance with ordinary accounting practice, and most importantly:

"… the expenditure incurred in obtaining the resource consents was indiscriminate as part of TrustPower's general business operations expenses. The expenditure was not to secure the specific consents, but to assist TrustPower in determining a source of supply of electricity. When seen from TrustPower's business and practical point of view, the resource consents are only one of the components of a particular project option, each option is part of the development pipeline as a whole, and the pipeline is only one of the possible sources of electricity to be sold by TrustPower. A grant of resource consents was necessary to advance a project along the development pipeline, but the grant was not in and of itself sufficient for a decision to be made to take any project through to the next stage."

Concluding observations

It remains to be seen whether the Commissioner will appeal this decision to the Court of Appeal.

Significantly, the Commissioner's attempt to draw adverse inferences from carefully selected email and other documentary evidence did not find favour with the High Court given the credibility of TrustPower's factual witnesses. This was undoubtedly a key to TrustPower's success.

Finally, it is noteworthy that the disputes process is just as cumbersome, time-consuming and costly even for a case involving black letter law (as opposed to general anti-avoidance) issues. The time for a further and more trenchant reform of the process must surely be fast approaching, to prevent taxpayer burn-off and develop New Zealand's tax law jurisprudence through substantive cases making it through to our courts.