**IN THE HIGH COURT OF NEW ZEALAND**
**CHRISTCHURCH REGISTRY**

**CIV-2015-409-017**
**[2016] NZHC 1015**

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| BETWEEN | ANZCO FOODS LIMITED<br>Plaintiff |
| AND | COMMISSIONER OF INLAND REVENUE<br>Defendant |

Hearing: 21 March 2016

Appearances: J H Coleman for the Plaintiff
M Deligiannis and K J Milton for the Defendant

Judgment: 18 May 2016

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**JUDGMENT OF MANDER J**

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[1] The plaintiff, ANZCO Foods Limited (ANZCO), seeks a declaration that tax assessments by the Commissioner of Inland Revenue (the Commissioner) are incorrect and for orders to be made cancelling the assessments.[1] ANZCO challenges the Commissioner's decision to disallow deductions claimed for depreciation based on a payment to allow it to undertake meat processing and freezing activities at a plant previously owned by rival meat processing company, AFFCO New Zealand Limited (AFFCO).

[2] The payment arose from a negotiated settlement to vary an encumbrance on land purchased by ANZCO. This encumbrance restricted ANZCO from using the land to freeze and process meat product. ANZCO treated the result of the settlement with AFFCO as conferring upon it a right to use land and sought to depreciate that item under the Income Tax Act 2007 (The Act).

1 Tax Administration Act 1994, s 138P.

**Background**

[3] During the 1990s AFFCO began closing a number of its meat processing plants. In September 1997 it closed its Waitara operation. In 1999 AFFCO sold the Waitara property to a third party for $3.2 million. In accordance with AFFCO's wider commercial strategy the sale and purchase agreement limited the use to which the purchaser could put the Waitara property. The agreement provided:

> The Purchaser covenants that it will not use the property, or any part of it for the purpose of slaughtering, further processing, cooling or freezing of lamb, sheep, bobby calves, cattle or goats for a period of twenty (20) years from the Possession Date.

[4] The agreement further required the purchaser to execute and permit registration of a memorandum of encumbrance to secure the performance of this covenant by the purchaser and its successors in title. A memorandum of encumbrance was registered against the Waitara land which reflected the terms of the agreement (the encumbrance).

[5] In that same year Riverlands Limited (Riverlands), a subsidiary of ANZCO, entered into an arrangement with the third party to blast freeze and store meat product at the Waitara site. In 2002 that arrangement was formalised by Riverlands entering into a lease with the third party purchaser. Proceedings were issued by AFFCO alleging the purchaser had breached the encumbrance by entering into such a lease and sought to prevent Riverlands' activities. This dispute between AFFCO and the purchaser was settled. As a result AFFCO did not pursue its claim against Riverlands and allowed it to use the land as intended for the purpose of the lease.

[6] In February 2004 ANZCO purchased the Waitara property from the third party purchaser together with the Riverlands' lease. The purchase price paid for the land and buildings was approximately $3.9 million.[2] The property was acquired subject to the encumbrance, although ANZCO did not accept that either it or Riverlands was bound by its terms. AFFCO had previously rejected an initiative by ANZCO to obtain a waiver of the encumbrance.

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[2] The total purchase price paid was $5,075,000 of which $1.17 million was in respect of equipment.

[7] At the time of ANZCO's purchase of the Waitara property, it intended to lease part of the plant to Itoham New Zealand Limited (Itoham), a joint venture company in which it held a 50 percent shareholding. ANZCO's plan was for Itoham to use Waitara to manufacture a variety of meat products such as salami and meat patties, expanding in the future to include other meat and food items and to cool or freeze that product at the Waitara site. ANZCO also intended to continue with Riverlands existing use of the Waitara plant to freeze meat.

[8] ANZCO did not consider these activities to come within the terms of the encumbrance. It believed the term "further processing" referred to in the memorandum of encumbrance did not extend to include the type of manufacturing processes Itoham intended to use the Waitara site for. AFFCO took a contrary view. In March 2004 it issued proceedings against ANZCO, Riverlands and Itoham, seeking an injunction to prevent those companies from using the land for the purpose of processing or manufacturing meat products.

[9] This Court found in favour of AFFCO[3]. The Court of Appeal subsequently held that AFFCO could not enforce its encumbrance against Riverlands because it retained the benefit of the waiver negotiated by the previous third party buyer and unlike ANZCO was not a successor in title.[4] However the Court confirmed that ANZCO was subject to the encumbrance. Because Itoham's use of the Waitara plant was derived from ANZCO it too was subject to the restrictions. The Court of Appeal rejected ANZCO's argument that the meat processing or manufacturing of the type intended to be carried out by Itoham was outside the terms of the encumbrance.

[10] Against the backdrop of an application by ANZCO for leave to appeal to the Supreme Court, negotiations were entered into between the parties. In July 2005 a settlement was reached. ANZCO agreed to pay $5,600,000 plus GST to use the Waitara property for the further processing, cooling and freezing of lamb, sheep, bobby calves, cattle and goats. To give effect to this agreement the words "further processing, cooling or freezing" were deleted from the terms of the encumbrance. The restriction on using the Waitara property for the slaughter of stock remained.

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3 *AFFCO New Zealand Ltd v ANZCO Foods Waitara Ltd* HC Wellington CIV-2004-985-499, 23 August 2004.

4 *ANZCO Foods Waitara Ltd v AFFCO New Zealand Ltd* [2006] 3 NZLR 351 (CA).

[11] For financial reporting and taxation purposes, ANZCO treated the agreement as constituting the purchase of a "right to use land." The settlement sum of $5,600,000 together with ANZCO's legal fees of $470,302 was capitalised and depreciated by it on that basis. It was recorded in the company's asset register and depreciated on a straight line basis of 7.1 per cent, with a fixed life of 14 years. ANZCO then spread the amounts over that period from the 2005 tax year onwards.

[12] ANZCO is the nominated company for tax purposes of the consolidated group called the ANZCO Foods Consolidated Group. While the specific entity involved with the Waitara plant was another member of the consolidated group, ANZCO Waitara Limited, it was ANZCO which entered into the settlement deed with AFFCO in July 2005. As the agent of the consolidated group it has brought the current proceeding against the Commissioner. Nothing turns on the separate corporate identities and roles of the companies within the consolidated group.

**The dispute**

[13] The Commissioner did not accept the money paid by ANZCO to AFFCO under the settlement deed was depreciable intangible property. In May 2013 the Commissioner issued a notice disallowing the claimed deductions of $430,991 for each of the 2009 to 2011 income tax years.[5]

[14] ANZCO challenges the Commissioner's assessments on the basis the settlement deed conveyed to it a right to use land which constitutes depreciable intangible property in respect of which it was entitled to claim deductions. The essential dispute between the parties therefore centres on the characterisation and subsequent tax treatment of what was obtained by ANZCO under the settlement deed. In particular, whether the payment to AFFCO was made to obtain an item of depreciable intangible property under the Act.

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[5] The Commissioner acknowledged the assessments for the 2005 to 2008 years were time barred. ANZCO's 2012 to 2015 tax returns have yet to be filed.

**Relevant provisions of the Act**

[15] Before turning to the merits of the parties' respective arguments it is necessary to set out the relevant provisions of the Act.

[16] Section DA 1(a)(i) of the Act allows a deduction for an amount of depreciation loss, to the extent that such loss was incurred by the taxpayer in deriving assessable income or was incurred in the course of carrying on a business for the purpose of deriving such income.

[17] Section YA 1 provides that a "depreciation loss" means "a loss that a person has in the circumstances set out in s EE 1(2)". Section EE 1(2) provides:

> *When amount of depreciation loss arises*
>
> (2) A person has an amount of **depreciation loss** for an item for an income year if—
>
> (a) the person owns an item of property, as described in sections EE 2 to EE 5; and
>
> (b) the item is depreciable property, as described in sections EE 6 to EE 8; and
>
> (c) the item is used, or is available for use, by the person in the income year; and
>
> (d) the amount of depreciation loss is calculated for the person, the item, and the income year under sections EE 9 to EE 11.

[18] Depreciable property is described in s EE6(1) as follows:

> *Description*
>
> (1) **Depreciable property** is property that, in normal circumstances, might reasonably be expected to decline in value while it is used or available for use –
>
> (a) in deriving assessable income; or
>
> (b) in carrying on a business for the purpose of deriving assessable income.

[19] This description of depreciable property is expanded on by reference to intangible property which is defined under subs (3) as follows:

*Property*: *intangible*

(3) An item of intangible property is depreciable property if –

(a) it is within the definition of **depreciable intangible property;** and

(b) it is described by subsection (1); and

(c) it is not described by section EE 7.

[20] The meaning of depreciable intangible property is provided by s EE 62, which states;

**EE 62 Meaning of depreciable intangible property**

*Meaning*

(1) **Depreciable intangible property** means the property listed in schedule 14 (Depreciable intangible property).

*Criteria for listing in schedule 14*

(2) For property to be listed in schedule 14, the criteria are as follows:

(a) it must be intangible; and

(b) it must have a finite useful life that can be estimated with a reasonable degree of certainty on the date of its acquisition.

*Schedule 14 prevails*

(3) Property that is listed in schedule 14 is depreciable intangible property even if the criteria are not met.

[21] Schedule 14 of the Act lists items which are to be treated as depreciable intangible property. It provides:

**Schedule 14**

**Depreciable intangible property**

1 the right to use a copyright

2 the right to use a design or model, plan, secret formula or process, or other like property or right

3 a patent or the right to use a patent

4 a patent application with a complete specification lodged on or after 1 April 2005

*5 the right to use land*

6 the right to use plant or machinery

7 the copyright in software, the right to use the copyright in software, or the right to use software

8 the right to use a trademark

9 management rights and licence rights created under the Radiocommunications Act 1989

(emphasis added)

[22] Finally, s EE 7 lists items that are not depreciable property:

> **EE 7 What is not depreciable property?**
>
> The following property is not depreciable property:
>
> (a) land other than depreciable intangible property, although buildings, fixtures, and the improvements listed in schedule 13 (Depreciable land improvements) are depreciable property if they are described by section EE 6(1):
>
> …

[23] The onus lies on ANZCO to prove on the balance of probabilities that the challenged assessments are wrong.[6]

## The competing positions

*ANZCO's analysis*

[24] ANZCO submitted the statutory requirements have been met allowing it to claim deductions for depreciation of an intangible piece of property, namely the right to use land acquired by it as a result of the settlement with AFFCO.

[25] Taking in turn each of the statutory preconditions to allow a deduction for loss set out in s EE 1(2) of the Act, ANZCO firstly submitted that it owned *an item of property*.[7] In the absence of any applicable statutory definition of the term "property" the ordinary meaning of that word is to be applied. The term "property" includes tangible goods, assets or land, but may also apply to non-tangible assets such as incorporeal forms of property, contractual rights, and intellectual property.[8]

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6 Tax Administration Act 1994, s 149(A); *Buckley & Young Ltd v Commissioner of Inland Revenue* [1978] 2 NZLR 485 (CA).

7 Income Tax Act 2007, s EE 1(2)(a).

8 *Laws of New Zealand*, Personal Property (online ed) at [5]-[7].

ANZCO submitted it obtained contractual rights which as a "chose in action" is capable of being assigned to others. As such it was a form of intangible property.

[26] ANZCO submitted that both it and its subsidiaries were granted the right to use the land for certain purposes, namely to use Waitara for the further processing and cooling or freezing of stock. ANZCO maintained these rights were definable, identifiable to third parties and capable of assignment or transmission to others.[9] Such contractual rights, it submitted, are as capable of being a form of "property" as any other intangible right.[10] It followed therefore that the rights it obtained as a result of the 2005 settlement constitute property and their categorisation as such involves no avoidance nor sham.

[27] Secondly ANZCO submitted *this item is depreciable property as described in sections EE 6 to EE 8.*[11] ANZCO argued the rights or interests it acquired from the settlement fall within the definition of depreciable intangible property under the Act.[12] Section EE 62(1) defines depreciable intangible property as property listed in sch 14. The schedule lists "the right to use land" as depreciable intangible property. This, it is contended, was what ANZCO received under the settlement.

[28] The phrase "the right to use land" is not defined in the Act, however each of the words that comprise the description, it was submitted, carry their ordinary meaning. The term "right" means an entitlement or justifiable claim, on legal or moral grounds, to have or obtain something or to act in a certain way.[13] "Use" has its ordinary meaning. "Land" is defined in s YA 1 of the Act as including any estate or interest in land, and an option to acquire land or an estate or interest in land, but does not include a mortgage.

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9 *National Provincial Bank Ltd v Ainsworth* [1965] AC 1175 (HL) at 1247-1248 per Lord Wilberforce.

10 *Trustees in the CB Simkin Trust v Commissioner of Inland Revenue*[2004] UKPC 55, (2005) 22 NZTC 19,001 [*Simkin Privy Council Decision*].

11 Income Tax Act 2007, s EE 1(2)(b).

12 Income Tax Act 2007, s EE 6(3)(a) and EE 62(1).

13 Oxford Dictionaries *Shorter Oxford English Dictionary* (6th revised edition, Oxford University Press, Oxford, 2007).

[29] ANZCO submitted the term "right to use land" means an entitlement to make use of an estate or interest in land for a particular end or purpose. This was what it had secured under the terms of the 2005 settlement deed.

[30] ANZCO argued the criteria in s EE 62(2) for the property to be listed in sch 14, that it be intangible and "have a finite useful life that can be estimated with a reasonable degree of certainty on the date of its acquisition", are met. In regard to the latter requirement, ANZCO submitted the rights acquired were for a finite time, namely for the remaining period of the encumbrance. In any event, the meeting of such criteria is not decisive. Section EE 62(3) provides that property listed in sch 14 is depreciable intangible property even if the criteria are not met.

[31] In order for the intangible property to be depreciable property under s EE 6, it must be property which in normal circumstances, might reasonably be expected to decline in value while it is used or available for use in deriving assessable income, or in carrying on a business for the purpose of deriving assessable income.[14] ANZCO submitted the settlement deed granted particular rights to use the land for the remaining period of the encumbrance which would expire after a set period of years. As a result ANZCO contended the rights can be expected to decline in value over the effluxion of this fixed period during which they would be used or available to be used.

[32] Section EE 6(3) excludes intangible property described by s EE 7. That section prescribes property which is not depreciable property and includes "land other than depreciable intangible property".[15] ANZCO submitted that what it acquired was a limited bundle of rights and not land.

[33] The third requirement of s EE 1(2) is that *the item is used or available for use*, by the taxpayer in the income year in question.[16] It is not disputed the rights secured by the settlement were used or available to be used by ANZCO in the tax years the subject of challenge.

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14 Income Tax Act 2007, ss EE 6(1)(a) and (b).
15 Income Tax Act 2007, s EE 6(3)(c).
16 Income Tax Act 2007, s EE 1(2)(c).

[34] Finally there is no dispute as to the correctness of the method by which the *depreciation loss has been calculated* under the Act with respect to the years the subject of dispute.[17] The computation of the figures is not in question.

[35] ANZCO submitted that it follows from this analysis that a right to use land was granted to it as a result of the settlement agreement reached with AFFCO. The statutory requirements of the Act have been met and the taxpayer is entitled to the depreciation allowance claimed.

*The Commissioner's position*

[36] The Commissioner disputes what ANZCO obtained as a result of the settlement constitutes depreciable intangible property. She urged the Court to accurately identify what ANZCO acquired and whether that item falls within the meaning of "depreciable intangible property" under the Act.

[37] Firstly, the Commissioner submitted in carrying out that exercise the labels or terms used by the parties to describe the transaction are not decisive, rather the substance of the transaction needs to be examined. The Commissioner submitted that all ANZCO acquired was the greater use of its own land by way of a variation of the encumbrance to which it was subject. This did not involve the creation of any new rights but rather the removal of a restriction on its enjoyment of the normal legal rights attaching to full ownership of the land.

[38] Secondly, the Commissioner submitted the "right to use land" as prescribed by sch 14 cannot be interpreted to include every right which attaches to the ownership of land. Importantly, it must be read consistent with the requirement that the item must depreciate over time. Section EE 62 provides that for an item to qualify under sch 14 it "must have a finite useful life that can be estimated with a reasonable degree of certainty on the date of its acquisition".[18]

[39] The Commissioner submitted that each of the items listed in the schedule are required to be interpreted in light of that description. Inherent to the concept of "a

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17 Income Tax Act 2007, s EE 1(2)(d).

18 Income Tax Act 2007, s EE 62(2)(b).

finite useful life is that the item must decline in value.[19] In the absence of such depreciation the item cannot constitute "depreciable intangible property." Whereas in AFFCO's hands the value of the restriction on the land may decline as the period of the limitation reduced there was no diminishment of the value of the rights in the hands of ANZCO over that same period.

[40] Thirdly, the Commissioner argued a related difficulty for ANZCO is that even if what ANZCO acquired falls within the category of "the right to use land" as listed in sch 14, it must additionally, in order to qualify as depreciable property, be an item described in s EE 6(1). It must be "property that in normal circumstances, might reasonably be expected to decline in value while it is used or available for use in deriving assessable income or in carrying on a business" for that purpose.[20]

[41] The Commissioner submitted the rights acquired by ANZCO do not have a finite lifespan but are inherent rights of ownership which continue to run with ANZCO's ownership of the land and are subject to no temporal restriction. In making that submission the Commissioner emphasised the distinction between what AFFCO possessed by way of the encumbrance, namely a limited restriction on the use of the land for a finite lifespan, and what ANZCO obtained as a result of the settlement.

[42] Finally, the Commissioner contested ANZCO's submission that what it obtained under the settlement deed was "property" in the sense of it being definable rights, identifiable to third parties and capable of assignment. The Commissioner submitted the intangible rights the subject of the settlement deed were merely pre-existing inherent rights of ownership which could not constitute separate "property" distinct from the ownership of the land.

[43] In summary, the Commissioner submitted that all ANZCO secured as a result of the settlement was its release from a restriction on the use of its own property. The removal of the encumbrance reinstated rights that attached to its ownership of the land. In so doing the capital value of the land was enhanced. The Commissioner

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19 *Trustees of the Simkin Trust v Commissioner of Inland Revenue* [2003] 2 NZLR 315 (CA) [*Simkin Trust Court of Appeal Descision*].

20 Income Tax Act 2007, s EE 6(1).

submitted there was a direct correlation between the payment of the settlement sum to secure the restoration of those ordinary rights of ownership and an appreciation of the value of the property. It would certainly not result in any depreciation of the value of those rights over subsequent years. The payment made by ANZCO was therefore capital in nature and not capable of being the subject of any deduction.[21]

**Issues**

[44] In order to assess the merits of the parties competing positions it is necessary to determine the following issues:

(a) What did ANZCO obtain as a result of its settlement with AFFCO?

(b) Did what ANZCO obtain constitute intangible depreciable property under the Act? Resolution of that issue will turn on the answer to the following questions:

(i) Was a "right to use land" as that term is to be interpreted in sch 14 of the Act, acquired as a result of the settlement?

(ii) If what was obtained was "a right to use land", was it depreciable property under s EE 6(1) of the Act?

**What did ANZCO obtain as a result of its settlement with AFFCO?**

[45] The settlement deed of July 2005 entered into by ANZCO and AFFCO provided as follows:

> **2. Grant of right to use land**
>
> (a) AFFCO hereby grants ANZCO Waitara, its tenants and/or assignees (including Itoham and Riverlands) the right to use the Waitara property for the further processing and cooling and freezing of lamb, sheep, bobby calves, cattle and goats …

[21] Income Tax Act 2007, s DA 2(1).

(b) The right to thus use the Waitara property is granted from the date of this Deed for the remaining period of the Encumbrance.

(c) Nothing in this clause gives the Defendants the right to use the Waitara Property for the slaughter of lamb, sheep, bobby calves, cattle and goats and the defendants agree not to do so during the term of the Encumbrance.

**3. Payment for grant of right to use land**

In consideration for AFFCO granting the right to use the Waitara Property as set out in clause 2, ANZCO agrees to pay AFFCO the total sum of $5,600,000 plus GST (if applicable), payable in one sum on the Settlement Date. Comprising $5,000,000 plus $600,000 legal fees.

[46] On the face of the contract a "right to use" the Waitara property was granted by AFFCO. The approach to be taken to the express words used by the parties in the contract was the subject of competing submissions.

[47] ANZCO emphasised the explicit wording of the text of the deed and submitted the way the parties had deliberately chosen to frame the transaction should be determinative. The Commissioner submitted the proper approach was to analyse the legal rights and duties created by the settlement deed as ascertained by ordinary legal principles taking into account the surrounding circumstances of the transaction. In her submission the "nomenclature" used by the parties in the wording of the contract, namely the words "a right to use land", was not decisive when analysing what had been conveyed by the settlement deed.

[48] The parties relied on different authorities in support of their respective arguments, however on closer analysis the cases are consistent. In *Buckley & Young Limited v The Commissioner of Inland Revenue,* the Court of Appeal observed:[22]

> …[I]t is well established that the true nature of a transaction must be ascertained by reference to the legal arrangements actually entered into and carried out … [T]he Judicial Committee [has] stressed that it is the legal character of the transaction actually entered into determined by the contractual arrangements which is decisive, not the overall economic consequences to the parties. Referring to the doctrine of substance, Lord Russell of Killowen said, in the *Duke of Westminster's* case:

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[22] *Buckley & Young Ltd v Commissioner of Inland Revenue*, above n 6, at 489-490.

> If all that is meant by the doctrine is that having once ascertained the legal rights of the parties you may disregard nomenclature and decide the question of taxability or non-taxability in accordance with the legal rights, well and good … If, on the other hand, the doctrine means that you may brush aside deeds, disregard the legal rights and liabilities arising under a contract between parties, and decide the question of taxability or non-taxability upon the footing of the rights and liabilities of the parties being different from what in law they are, then I entirely dissent from such a doctrine …
>
> While the nomenclature used by the parties is not decisive, it is the legal rights and duties created by the transaction to which the parties entered and as ascertained by ordinary legal principles, taking into account surrounding circumstances, that must be determined. Thus, while it is legitimate to take into account surrounding circumstances and to refuse to be blinded by terms employed in documents, the documents themselves may be brushed aside only if and to the extent that they are shams …
>
> (citations omitted)

[49] Similarly, in *Mills v Dowdall*, the Court of Appeal emphasised the need to focus on what rights and obligations had been created by the contract:[23]

> The legal principles governing the ascertainment of the true legal character of a transaction are now well settled … It frequently happens that the same result in a business sense can be attained by two different legal transactions. The parties are free to choose whatever lawful arrangements will suit their purposes. The true nature of their transaction can only be ascertained by a careful consideration of the legal arrangements actually entered into and carried out. Not on an assessment of the broad substance of the transaction measured by the results intended and achieved; or of the overall economic consequences to the parties; or of the legal consequences which would follow from a different course, which they could have adopted had they chosen to do so. The forms adopted cannot be dismissed as mere machinery for effecting the purposes of the parties. It is the legal character of the transaction that is actually entered into and the legal steps which are followed which are decisive.

[50] While concerned with an issue of tax avoidance the Supreme Court's approach in *Ben Nevis Forestry Ventures Limited v Commissioner of Inland Revenue* aligns with that taken by the Court of Appeal when determining the nature of the rights and obligations created by a contract for the purpose of applying the Act's provisions:[24]

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[23] *Mills v Dowdall* [1983] NZLR 154 (CA) at 159; *R*e *Securitibank Ltd* (No 2) [1978] 2 NZLR 136 (CA); *Buckley & Young Limited v CIR*, above n 6.

[24] *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289.

> [46] …The Court must construe the relevant documents, in their commercial context, to ascertain the parties' obligations to each other, as if it were determining a dispute between them over the meaning and effect of their contractual arrangements.
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> [47] In proceeding in this way, the Court must also respect the fact that frequently in commerce there are different means of producing the same economic outcome which have different tax consequences. When considering the application of a specific tax provision, before reaching any question of avoidance, the Court is concerned primarily with the legal structures and obligations the parties have created and not with conducting an analysis in terms of their economic substance and consequences, or of alternative means that were available for achieving the substantive results.
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> [48] On the other hand, it is the true meaning of all provisions in a contract that will determine the character of a transaction rather than the label given to it. The label "licence premium" is accordingly not what is important in the present case, but rather the true contractual nature of the legal rights for which payment is to be made and the effect of applying the tax legislation to a payment of that character. Once the nature of the contractual rights and obligations has been determined in this way, the specific provision can be applied.

[51] ANZCO submitted this was not a situation where inaccurate nomenclature had been used in the sense of a label being applied to deliberately mis-describe the subject of the contract. Absent any sham or fraud the words used by the parties to the deed to describe the nature of their transaction should prevail.

[52] However the descriptor used in the terms of the contract cannot by itself be determinative. As is apparent from the cases cited, the legal character of the transaction is to be ascertained by careful consideration of the contractual arrangements entered into; this must be the focus. This requires the nature of the item of property that was conveyed as a result of the settlement to be accurately identified. As Richardson J observed in *Mills v Dowdall*, "[i]t is the legal character of the transaction that is actually entered into and the legal steps which are followed which are decisive."[25]

[53] AFFCO did not hold or own any rights to use the Waitara property. In particular, it had no rights to use the property for the purposes of slaughtering, further processing, cooling or freezing particular types of livestock. The restriction contained in the original 1999 sale and purchase agreement between AFFCO and the

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[25] *Mills v* Dowdall, above n 23, at 159.

third party did not equate to any retention by AFFCO of a right to use the property in any way. Rather, the covenant entered into by the third party purchaser was negative in nature restricting the use to which the Waitara property could be put. The enforcement of that restriction against a successor in title was secured by the execution and registration of the encumbrance.

[54] The third party purchaser obtained from AFFCO an estate in fee simple. Ownership of a fee simple estate has been described in the following terms:[26]

> An estate in fee simple is, "for almost all practical purposes, the equivalent of full ownership of the land" and confers "the lawful right to exercise over, upon, and in respect to, the land, every act of ownership which can enter into the imagination." It simply does not permit of the enjoyment by anyone else of any right or interest in respect of the land unless conferred by statute, by the owner of the fee simple or by a predecessor in title.

[55] There are now many statutory limitations on the absolute rights of use and enjoyment of a fee simple estate, however the essential point remains. In the absence of a fee simple estate being otherwise limited, the owner has full rights to use the land as they please. Those rights can be broadly categorised as possession, use and enjoyment, and alienation. In respect of rights of use and enjoyment, fee simple ownership confers the most absolute rights in land of all legal estates.[27]

[56] As already observed, AFFCO when it sold the Waitara property did not retain any of the rights attaching to the fee simple estate. All it obtained under the sale and purchase agreement was a requirement that the purchaser execute and permit registration of a memorandum of encumbrance securing the purchaser's performance of its contractual obligation not to use the Waitara property for particular purposes.

[57] In the litigation that followed the sale of the Waitara property to ANZCO in February 2004, the nature and status of the encumbrance was considered by the Court of Appeal.[28] In considering whether the encumbrance directly bound ANZCO and its subsidiaries, William Young J examined the form of the restriction on the land to which it gave effect. The Court observed that in the case of an orthodox

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26 *Fejo v Northern Territory of Australia* [1998] HCA 58, (1998) 195 CLR 96 at [43].
27 *Wik Peoples v State of Queensland* [1996] HCA 40, (1996) 187 CLR 1 at 176.
28 *ANZCO Waitara Ltd v AFFCO New Zealand Ltd*, above n 4.

restrictive covenant by which restrictions are imposed in respect to one area of land for the benefit of other land, there will be a dominant and servient tenement. The burden of the covenant runs with the servient tenement and can be enforced against the successors of the original covenantor. Similarly, the benefit of the covenant runs with the dominant tenement and thus the covenant can be enforced by the successors of the original covenantee.

[58] The restrictive covenant in the present case does not attach to any dominant tenement. William Young J observed that in such a situation if the covenant contained in the encumbrance is to be properly regarded as a "restrictive covenant" it is a restrictive covenant in "gross".[29] Such a covenant can be enforced as between the original parties but whether the burden of such a covenant runs with the servient tenement is moot. The Land Transfer Act does not provide any mechanism by which restrictive covenants in gross can be registered. Because of the indefeasibility of title, in the absence of a restrictive covenant in gross being able to be registered against land, no subsequent purchaser can be bound by its terms.

[59] To avoid the difficulties of enforcing restrictive covenants in gross, various conveyancing techniques have been employed to replicate the result otherwise obtained by registration of the covenant against the title.[30] One of those techniques is the execution of a memorandum of encumbrance. Because a memorandum of encumbrance is a mortgage and thus registrable, it is enforceable against the covenantors' successors in title under section 104 of the Property Law Act 2007.[31] The usual remedies of a mortgagee, including the power of sale, are available if such a covenant is breached. It follows that such an encumbrance is an effective mechanism for enforcement and a means by which the covenantee can ensure those who deal with the affected land have notice of the restrictive covenant in gross.[32]

[60] The Court of Appeal's analysis confirms that when AFFCO entered into the sale and purchase agreement with the third party in 1999 it did not retain any subset of rights attaching to the fee simple estate. What rights it acquired to prevent the

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29 At [46].
30 At [50].
31 At [51].
32 At [52] and [55].

use of the land for certain purposes were distinct from that bundle of rights and in particular from the right to use the land. The third party agreed to restrict its use of the Waitara land for particular purposes. It was that restrictive covenant enforceable in the hands of AFFCO (or its assignees) which the memorandum of encumbrance as a form of registrable mortgage ensured could be enforced against any successor in title to the Waitara land, at least until the expiration of its term.

[61] Clause 5 of the settlement deed reads:

> **5. Amendment of encumbrance**
>
> To give effect to the *granting of the right to use the Waitara property for the manufacture of processed foods* AFFCO and ANZCO Waitara (and if necessary, Itoham and Riverlands) agree that with immediate effect the encumbrance is amended by deleting from clause 2 of the Encumbrance the words "further processing, cooling or freezing".

(emphasis added)

[62] As the above analysis demonstrates AFFCO actually had no rights itself to use the Waitara property for the manufacture of processed foods to convey to ANZCO. The covenantee had the power to release the covenantor from the restrictive covenant. It could also sell or assign the benefit of the restrictive covenant, perhaps to another competitor of ANZCO. Importantly, however there was no right to use the land independent of ANZCO's ownership of the fee simple estate which could be traded.

[63] ANZCO's argument based on the parties choice to frame the agreement in terms which referred to the granting of rights to use the Waitara property, cannot change the effect of the legal arrangements entered into which resulted in ANZCO being released from its obligation to abide by the restrictive covenant thereby allowing it to exercise its previously encumbered rights to use the property for particular purposes. The amendment of the encumbrance by removing a restriction on existing rights which formed part of the fee simple estate held by ANZCO is not to be equated with a conveyance or grant of rights held or enjoyed by AFFCO.

[64] Underscoring this finding that AFFCO only held a restriction on the use to which ANZCO could put its own rights, is the fact the restriction was limited to a

finite period after which the covenant expired. Upon that event triggering, no "right to use land" passed to the land owner, rather the contractual restriction (the "chose in action") secured by the encumbrance would extinguish.

[65] An examination of what ANZCO obtained as a result of the settlement brings into relief an apparent inconsistency in ANZCO's own analysis of the Act's application. In identifying the item of intangible property in respect of which it seeks to claim a loss for depreciation, ANZCO submitted it obtained a "chose in action", namely contractual rights capable of assignment to others.

[66] I accept this is what AFFCO held. However, the contractual right or chose in action which constitutes the intangible property is the right to enforce a restriction or prohibition on the use of land.[33] As observed AFFCO never held a right to use land, which is different from a contractual restriction preventing another from using its own land for certain purposes. ANZCO identified the contractual right of restriction as being the intangible property for which it claims a deduction for depreciation, yet in the hands of the owner of the land the intangible property, the "chose in action", upon which the claim for depreciation is dependent no longer exists. The property owner's rights are no longer encumbered and the chose in action, the right to enforce that aspect of the contract, evaporates. The intangible property of the type contended for by ANZCO therefore only exists as a separate item of property in the hands of AFFCO or another third party.

[67] An analogy can be drawn with the more common situation of a loan contract which is secured by a mortgage. Upon the loan being paid off the mortgage can be discharged. While the obligation to pay the loan, the chose in action, can be assigned or sold to another, once the liability to pay is discharged by the debtor, the contractual right of enforcement no longer exists.

[68] In the present case, restrictions on the use of the land were lifted upon payment by the owner of an agreed sum. As a result, the encumbrance (itself a form of mortgage) was varied. The right to enforce those restrictions on the use of the

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[33] *Laws of New Zealand* Choses in Action (online ed) at [1].

land, being the chose in action identified by ANZCO and upon which its claim for depreciation rests, no longer existed as an item of intangible property.

[69] In theory, ANZCO could in the future enter into a contractual arrangement restricting the use to which its land is put for certain purposes, but the contractual rights created in the hands of the other party would be a distinct chose in action or item of intangible property. Importantly, it would not involve the conveyance of any right to use the land. It is difficult therefore to conclude why the reversal of such a transaction, which the settlement the subject of the present proceeding constitutes, should be construed as such.

[70] ANZCO submitted the ordinary meaning of the term "right to use land" should be applied to those words as used both in the settlement deed and the Act. However, the contractual right or chose in action identified by ANZCO as the item of intangible property acquired as a result of the settlement was indeed simply that – a contractual obligation. AFFCO never had a right to use land which it could convey to a third party.

[71] ANZCO cautioned against going behind the words of the settlement deed. Undoubtedly the effect of the settlement was to allow ANZCO to exercise rights which for a period were otherwise unavailable to it in the absence of AFFCO's permission. Only AFFCO had the power to grant such access and in purchasing from AFFCO the restriction that applied to the land which prohibited its use for particular purposes, it allowed ANZCO to access rights which were otherwise for a limited period unavailable to it. However, for the reasons considered, I have concluded that what ANZCO obtained from the settlement was not a "right to use land" but the removal of a contractual restriction over its existing rights of use.

[72] In the event, this determination about whether ANZCO obtained a right to use land under the settlement is not pivotal. From the legal arrangements entered into I favour the conclusion that it did not. Such a conclusion most accurately reflects the true nature of the transaction which the settlement deed gave effect. However another formidable and ultimately unavoidable difficulty for ANZCO is that if an

item of property was obtained capable of being construed as a right to use land, it was not an item of depreciable intangible property under the Act.

**Did what ANZCO obtain constitute intangible depreciable property under the Act?**

*Was a "right to use land" as that term is to be interpreted in schedule 14 of the Act, acquired by ANZCO as a result of the settlement?*

[73] Schedule 14 of the Act lists "the right to use land" as an item of depreciable tangible property. The Commissioner argued the right or interest acquired by ANZCO as a result of the settlement is not one which falls within the schedule. In support of her argument she draws upon rules of statutory interpretation, including the legislative history of the Act, and relevant case law.

[74] As already noted ANZCO submitted that in the absence of any statutory definition the words used in the schedule should be interpreted in the ordinary way. The term "right to use land" encompasses an entitlement or justifiable claim to make use of an estate or interest in land for a particular end or purpose.[34] This, it was submitted, was what was acquired as a result of the 2005 settlement.

[75] The meaning of an enactment is to be ascertained from its text and in the light of its purpose.[35] Revenue statutes are no different.[36] Even where the meaning may in isolation appear plain it is always to be checked against the purpose of the statute. In turn, in determining statutory purpose, the Court is required to have regard to both the immediate and general legislative context and the objective of the enactment.[37]

[76] The Commissioner in her submissions made reference to the work of the Consultative Committee on The Taxation of Income from Capital (the Valabh Committee) which completed a review of the New Zealand tax system in 1991 with a particular focus on the taxation of income from capital.[38] The committee

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34 Income Tax Act 2007, s YA 1.

35 Interpretation Act 1999, s 5(1).

36 Income Tax Act 2007, s AA 3(2).

37 *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36, [2007] 3 NZLR 767 at [22] – [24].

38 Consultative Committee on the Taxation of Income from Capital *Tax Accounting Issues* (February 1991).

recommended that depreciable property should be extended to include intangible assets that could be expected to fall in value over their estimated useful life. Such intangible assets were not to include those that had an indeterminate economic life at the time of creation or acquisition.[39] These recommendations were accepted and provided the basis upon which the current rules now contained in subpart EE of the Act are based.

[77] The Commissioner emphasised that "a right to use land" in sch 14 must be interpreted consistently with the inherent rights of fee simple ownership which is generally to be considered as a capital asset. Section EE 7(a) provides that land (other than depreciable intangible property) is not depreciable property. That aligns with the purpose of the Act which is to provide a system to tax net income. Capital is not included in a person's income under the Act unless explicitly stated and s DA 2(1) prohibits a deduction for an amount of expenditure or loss that is of a capital nature.

[78] Both sections EE 6 and EE 62 which govern the meaning of depreciable property, and in particular depreciable intangible property for the purpose of claiming a deduction, provide further guidance as to what is meant by the term "the right to use land" as those words are used in sch 14. Section EE 6(1) describes depreciable property as being property that "in normal circumstances" might reasonably be expected to decline in value. Section EE 62(2)(b) provides that for property to be listed in sch 14 it must have a finite useful life that can be estimated with a reasonable degree of certainty on the date of its acquisition.

[79] In the *Simkin's Trust case*, the Court of Appeal and the Privy Council held that items listed in the schedule as depreciable intangible property are to be interpreted in accordance with such criteria.[40] In that case trustees purchased trademarks which they licensed to the vendors on payment of royalties with a sale back to the vendors after a period of some years. The trustees claimed deductions for depreciation on the trademarks as intangible property based on the difference

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39 At [8.5.2] – [8.5.4] of the report.

40 *Simkin Trust Court of Appeal Decision*, above n 19; *Simkin Trust Privy Council Decision*, above n 10.

between the acquisition and sale prices, notwithstanding the vendors having been licensed to use the trademark during the intervening period.

[80] The Court of Appeal considered the statutory criteria for the inclusion of property in the schedule that it have "a finite useful life that can be estimated with a reasonable degree of certainty on the date of its acquisition."[41] Schedule 17 to the Income Tax Act 1994 (the predecessor to sch 14 of the 2007 Act) listed "the right to use a trademark" as an item of intangible depreciable property. The Court observed that what is meant by that term is a matter of construction to be discerned from the words used in their full context and that each of the items listed in the schedule were to be interpreted against the statutory criteria.

[81] Care is required in applying the Court of Appeal's analysis to the present situation. The *Simkin Trust case* concerned s OB 1 of the Income Tax Act 1994 which was the predecessor to s EE 62 of the 2007 Act. It provided:

> **Depreciable intangible property** means intangible property of a type listed in Schedule 17, which Schedule describes the intangible property that has –
>
> (a) A finite useful life that can be estimated with a reasonable degree of certainty on the date of its creation or acquisition; and
>
> (b) If made depreciable, a low risk of being used in tax avoidance schemes.

[82] The wording of s EE 62 which is set out at [19] is different. While s EE 62(2) substantially provides the same criteria for property to be listed in sch 14, including that it must have a finite useful life that can be estimated with a reasonable degree of certainty on the date of its acquisition, subs (3) expressly states that property listed in the schedule is depreciable intangible property, even if the criteria are not met. The 1994 Act had no equivalent to subs (3).

[83] The Court of Appeal proceeded to examine the items of property listed in the schedule on the basis that each was to be interpreted in light of the statutory description or criteria. The Court noted two of the items listed in the schedule, namely item 3, "a patent or the right to use a patent", and item 6, "the copyright in

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[41] Income Tax Act 1994, sch 17; Income Tax Act 1976 s 107A.

software, the right to use the copyright in software, or the right to use the software", included the intangible property itself in addition to the right to use the property because both had a finite useful life. The remaining items listed in the schedule were limited to the right to use certain property.

[84] The Court of Appeal accepted the Commissioner's rationale for including in items 3 and 6 the statutory and intellectual property rights themselves (a patent and the copyright in software) but not including the corresponding rights in other items such as designs and confidential information (item 2), and trademarks (item 3) as reflecting deliberate policy. That policy was identified as being consistent with the view that a patent and copyright in software have a finite useful life that can be estimated with a reasonable degree of certainty from the date of creation or acquisition. The other items, including those relating to the rights of use of tangible items such as land and plant and machinery (items 4 and 5), were held as clearly being limited to rights distinguishable from rights inherent to the ownership of the item of itself, which were subject to no temporal limitation.[42]

[85] The Court of Appeal observed that a licensee may acquire a right to use an intellectual property right and where that right is for a finite term it may be expected to decline in value through the period of that term. The capital expense in acquiring the right will be depreciable over the period the right is enjoyed. The Court of Appeal however held that such a "right to use" is different intangible property from the right of ownership of the intellectual property. Importantly for the present case, the Court held that in this context, "the right to use a trademark in sch 17 means the right in fact to use."[43]

[86] In relation to the particular issue before the Court it concluded:

> [25] … Trade mark ownership rights are not property which might reasonably be expected in normal circumstances to decline in value while used so as to meet the definition of "Depreciable property." Therefore it would not be expected that the ownership rights the appellants seek to depreciate would be included as depreciable intangible property.

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42 *Simkin Trust Court of Appeal Decision*, above n 19, at [18] – [21].
43 At [24].

> [26] Accordingly, we are satisfied that the ownership rights the appellant seek to depreciate are not the rights to use trade marks to which item 7 of schedule 17 relates. Therefore, it does not avail the appellants to point to the finite period of ownership and disparity of consideration between the acquisition and disposal.

[87] On appeal to the Privy Council, the Judicial Committee observed the unusual nature of the definition contained in s OB 1 and queried the purpose it intended to serve. Their Lordships questioned whether it was meant to be "merely explanatory of the reasons for the selection of the particular types of intangible property listed in [the] schedule", or whether the provision prescribed criteria for an item's inclusion.[44] The changed wording of the provision's successor, the present s EE 62(2), explicitly states the subsection provides criteria for property to be listed in sch 14. However that statement appears difficult to square with subs (3) which provides that property listed in the schedule is depreciable intangible property even if the criteria are not met.

[88] In any event, the Board had little difficulty in disposing with the appeal. They interpreted the item in question, the right to use a trademark, by reference to the distinguishing feature between items included in the schedule and those excluded. Lord Scott stated:[45]

> 8. Their Lordships draw attention to what is not to be found in schedule 17. Copyright, other than copyright in software or in a sound recording, is not depreciable intangible property. Nor is a trademark. What distinguishes these types of intangible property from those that are included is the longevity of the useful life of the omitted types. A trademark does not have a "finite useful life." Its useful life can continue indefinitely. The right to use a trademark, on the other hand, will last only for as long as the trademark owner has granted that right.

[89] ANZCO, while acknowledging the case to be illustrative of the need to distinguish between an item of property and separate rights which may attach to that item, submitted the *Simkin Trust case* was factually different from the present situation. ANZCO argued the owner of the trademark in that case, unlike itself, had no separate contractual right to use the property in question (the trademark), whereas in the present situation because of the unusual chain of events it had secured a contractual right to use the land in a particular way. ANZCO submitted this

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44 *Simkin Trust Privy Council Decision*, above n 10, at [6].

45 At [8].

contractual right was capable of sale, assignment and licensing to a third party. It drew an analogy with lawful arrangements regarding the conveyance or disposition of interests and rights in land to oneself as demonstrating that as a matter of law there was no impediment to ANZCO as the owner of land holding at the same time a deed granting the right to use that land for specific purposes.[46]

[90] That submission however does not address the more fundamental question of whether what was conveyed as a result of the settlement was the removal of a restriction which freed existing rights attaching to ANZCO's ownership of the land, or a separate discrete right of use. It was clearly premised on the assumption of the latter. Nor does it squarely face the difference between the creation or transfer of a separate estate or interest in land by an owner of that land to oneself, and the discharge of a contractual obligation and the elimination of an enforceable right in the hands of another which the settlement gave effect to.

[91] The Court of Appeal in the *Simkin Trust case* held the items listed in the schedule were to be interpreted consistently with the criterion that the property must have a finite useful life that can be estimated with a reasonable degree of certainty on the date of its creation or acquisition.[47] The rights to use land, which are the subject of the present dispute, are rights inherent to the ownership of the land. While those rights can be restricted, they could not in isolation, at least in the form held by AFFCO, have been exercised independently from the ownership of the land itself. The right to use the land for the purposes restricted by the encumbrance continued to attach to the ownership of the land indefinitely, and would not in normal circumstances be expected to decline in value over time.

[92] While the *Simkin Trust case* involved rights to use intellectual property, the Court of Appeal's observation that "the right to use a trademark" listed in the schedule means the right "in fact to use", is instructive. The trustees could not claim depreciation on their ownership rights because while a licensee could claim depreciation on the declining value of its licence to use the trademark as it reduced

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46 Property Law Act 1952, s 49; Property Law Amendment Act 1968, s 66A; Property Law Act 2007, ss 56 and 278; *Harding v Commissioner of Inland Revenue* [1977] 1 NZLR 337 (SC), and *Robert Bryce Co Ltd v Stonehill Investments Ltd* [2000] 3 NZLR 535 (CA).

47 *Simkin Trust Court of Appeal Decision*, above n 19, at [18].

over the term of the licence, the right to use the trademark sourced from the ownership of the trademark itself would not decline over time.

[93] AFFCO, as already observed, never acquired any right "in fact" to use the land, only a right to prevent the owner from "in fact" using it. The right to actually use the land remained throughout with ANZCO as it had with the original third party purchaser of the fee simple estate.

[94] The observation that the "right to use" listed in the schedule is a right to actual use of the property is consistent with the approach taken by Tipping, McGrath and Gault JJ in their joint judgment in *Ben Nevis Forestry Ventures Limited v Commissioner of Inland Revenue*.[48] Their Honours considered a licence provided to the taxpayer to go onto a third party's land to conduct an aspect of business was a "right to use land", the payment for which was deductible as depreciation on depreciable property.[49] Similarly the New South Wales Court of Appeal considered an agreement to access rail infrastructure facilities in situ amounted to a right to use land for the purpose of the Duties Act 1997 (NSW).[50] Such illustrations are hardly exhaustive of the parameters of a right to use land but indicate that such a right is to be understood in its conventional sense of a right to physically access land for a particular purpose.

[95] In the *Simkin Trust case* the Court of Appeal held the ownership rights the trustees sought to depreciate did not include "the right to use a trademark" as that term is to be interpreted in the schedule. The trustees could not rely on its period of ownership, during which the rights to use the trademarks were licensed to another, to claim the reduced value between the initial purchase of the trademarks and their subsequent sale as evidence of depreciation over a finite period. Similarly, in the present case, the difference between the original purchase price for the Waitara property and the total sum paid after the subsequent payment of the $5.6 million to obtain release of the restrictions on the use of the land, even if said to represent value

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48 *Ben Nevis Forestry Ventures Limited v Commissioner of Inland Revenue*, above n 24.

49 At [54].

50 *Chief Commissioner of State Revenue (NSW) v Pacific National (Act) Limited* [2007] NSWCA 325, (2007) 70 NSWLR 544, confirmed on appeal in *Asciano Services Pty Ltd v Chief Commissioner of State Revenue* [2008] HCA 46, (2008) 235 CLR 602.

for the period the purchaser could not exercise those rights, applies to the capital value of the rights of ownership inherent in the fee simple estate. Those ownership rights would not be expected to decline over time.

[96] The "right to use land" as that term is used in sch 14, must be read in its statutory context – the objective of the Act, and in particular the purpose for which sch 14 was provided. The statutory intent of the criteria used in s EE 62 was to limit the interpretation of items of intangible property listed in the schedule to those that depreciate. This is consistent with the statutory purpose of the legislation to allow a deduction for an item of property used in deriving assessable income which declines in value over a finite period.

[97] In *Commissioner of Inland Revenue v Trustpower Limited* [*Trustpower*] the Court of Appeal considered the depreciation regime provided by the Act.[51] The case concerned deductions for expenditure incurred in the acquisition of various resource management consents. The consents included land use consents, water permits and discharge permits. The land use consents were for an unlimited duration, whereas the other permits were for fixed periods and would expire after a number of years.

[98] The predecessor to the current regime, sch 17, also listed consents granted under the Resource Management Act 1991 as items of depreciable intangible property. In considering whether resource consents, as that term is described without qualification in the schedule, were intangible depreciable property, the Court of Appeal distinguished between the land use consents which were for an unlimited duration and the water and discharge permits which had been granted for fixed periods. The Court held:

> [25] In the case of intangible property, this provision [section EE 6] will apply if the three requirements of s EE 6(3) are met. As the cl 9 resource consents are "depreciable intangible property", the first requirement is met. The land use consents of unlimited duration are not within the definition of "depreciable intangible property" because without a fixed term they cannot be "expected to decline in value" over time.

[99] The approach taken by the Court of Appeal demonstrates that notwithstanding s EE 62(3), which provides that property listed in the schedule is

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[51] *Commissioner of Inland Revenue v Trustpower Ltd* [2015] NZCA 253, [2015] 3 NZLR 658.

depreciable intangible property even if the criteria are not met, the meaning of items listed in the schedule are still to be interpreted in accordance with the criteria provided in subs (2). Because the land use consents were not subject to any fixed term it was accepted they could not be expected to decline in value. That finding may be viewed as an amalgam of the criterion in s EE 62(2)(b) and the qualifying description of depreciable property in s EE 6(1), but the effect is the same; intangible depreciable property cannot include property that does not have a limited useful life.

[100] ANZCO's argument was that the intangible property it purchased was subject to a limited lifespan and that as the period during which its use of the land would otherwise have been the subject of the encumbrance reduced, so did the value of the intangible property it purchased over this finite period. I consider that submission under the next heading which addresses the statutory description of what is depreciable property.

*Was the "right to use land" depreciable property under section EE 6(1) of the Act?*

[101] Even if I were to proceed on the basis the interest or right conveyed under the settlement deed was capable of constituting a right to use land under sch 14, ANZCO must still satisfy the requirement of s EE 6(3)(b) that the intangible property was depreciable property under subs (1). In order to be depreciable the item of intangible property must be property that in normal circumstances, might reasonably be expected to decline in value while it is used or available for use in deriving assessable income or in carrying on a business for such purpose.

[102] As is apparent from the discussion above, ANZCO is unable to satisfy that test. What was conveyed to it under the settlement deed was the restoration of inherent rights of ownership. The encumbrance held by AFFCO was for a limited period. However, once that period expired ANZCO's full ownership rights would revive in perpetuity. ANZCO effectively bought out the restriction which prevented the use of its ownership rights which in normal circumstances would not be expected to decline in value. The reinstated rights of ANZCO to undertake further processing, cooling and freezing at the Waitara plant would continue to run with its ownership of

the land long after the expiration of the restrictive covenant to which the encumbrance gave effect.

[103] The situation is to be examined from the position of the taxpayer. ANZCO sought to rely upon the reducing price it would expect to pay to remove the restriction over the period of the encumbrance. ANZCO submitted this represented the declining value of the intangible property, presumably the "chose in action", against which it was entitled to claim depreciation.

[104] However that analysis views the position from the perspective of AFFCO while it held the benefit of the restrictive covenant. The variation of the encumbrance over ANZCO's use of the land was no doubt of a quantifiable value to it for which it paid the agreed sum. However the consideration paid was to restore rights or to access rights which were already part of its fee simple estate. Once ANZCO secured those rights it had the benefit of them for all time, or at least until it sold the property at which time the capital value of the property would reflect the rights of use attaching to the land.

[105] As discussed at [64] – [65], there is an inconsistency in the approach sought to be taken by ANZCO. It relied on the term of the encumbrance as providing a finite period during which the value of the restrictive covenant preventing ANZCO's use of the land would reduce. It argued that in effectively buying the restriction from AFFCO it bought the right to use the land which as the period of the encumbrance reduced the value of the right depreciated.

[106] However the value of the right to use the land which ANZCO could not initially access when it purchased the Waitara property would have continued after the encumbrance expired. The worth of the restrictive covenant declined over time, but it does not follow the value of the right to use the land reduced. ANZCO argued that what was conveyed to it was a right to use land but it relies on the value of the restriction on its use of the land in the hands of a competitor to meet the statutory requirement that the intangible property depreciated over time. This highlights that what ANZCO acquired as a result of the settlement was not a right to use land but

the discharge of a limitation over a right it already held as the owner of the fee simple state.

**Conclusion**

[107] From my consideration of each of the identified issues I have concluded that what ANZCO obtained pursuant to the settlement deed was a variation of the encumbrance which secured a contractual restriction on the landowner's rights of ownership. AFFCO had no actual right to use the Waitara land to convey to ANZCO.

[108] The meaning of a "right to use land" as listed in sch 14 as depreciable intangible property does not extend to include rights which form part of the ownership of the fee simple estate. The rights to use the land which became available to ANZCO as a result of the settlement do not have a finite useful life over which they will depreciate. As a consequence the payment made by ANZCO to obtain the variation of the encumbrance in order to access those rights reflects the increased capital value of the property in the hands of the owner.

[109] The intangible property identified by ANZCO was the restrictive covenant secured by the encumbrance. While the value of that restriction in AFFCO's hands as a competitor of ANZCO reduced as the period of the covenant diminished, the value of the rights to use the land which were restricted by the covenant would not diminish over time in the hands of the landowner. It follows that there could be no expectation that such property rights would decline in value while being used to derive assessable income. In the absence of the value of the rights to use the land declining, such intangible property does not qualify as depreciable property under the Act.

[110] In summary, when ANZCO acquired the land, it acquired all the rights of use that a fee simple estate conveys, save for rights that were ring-fenced by the encumbrance which secured the contractual promise originally obtained by AFFCO when it sold the Waitara property in 1999. The non-fenced rights were conveyed for an indefinite term which could not be the subject of depreciation as there could be no expectation of any reduction in value.

[111] The settlement deed varied the terms of the encumbrance. The fenced off area was reduced, with some rights remaining cordoned off until the end of the encumbrance. However, the lifting of the restriction over the rights of use by the variation of the encumbrance enabled those rights to be enjoyed along with the rest of the rights which made up the fee simple estate. The rights thereby released were no longer subject to a fixed term, but continue to run with the land and cannot reasonably be expected to decline in value over time. It follows that what was obtained by ANZCO did not fall within the definition of depreciable intangible property provided in the Act.

[112] Although the settlement deed may describe the transaction in terms of AFFCO granting to ANZCO the right to use the Waitara property in a particular way, the true contractual nature of the settlement was that the ambit of the encumbrance was simply reduced. At that point there was no basis upon which the previously encumbered rights could reasonably be expected to decline in value.

**Result**

[113] ANZCO's application for a declaration that the Commissioner's assessments are incorrect and for orders cancelling the assessments are declined. The Commissioner's assessments for the 2009 to 2011 tax years are confirmed as correct.

**Costs**

[114] The Commissioner is entitled to costs on a category 2B basis. In the absence of the parties being able to agree costs and disbursements they are to exchange and file memoranda within 14 and 21 days respectively.

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