IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

I TE KŌTI MATUA O AOTEAROA
TĀMAKI MAKAURAU ROHE

CIV-2017-404-000169
CIV-2017-404-000517
[2019] NZHC 1524

BETWEEN	MERCURY NZ LIMITED Plaintiff
AND	THE COMMISSIONER OF INLAND REVENUE Defendant

Hearing: 17-21 June 2019

Appearances: L McKay, L Fraser and W Cheyne for the Plaintiff
V Casey QC, P Courtney and C L White for the Defendant

Judgment: 1 July 2019

JUDGMENT OF HINTON J

This judgment was delivered by me on 1 July 2019 at 4.45 pm
pursuant to Rule 11.5 of the High Court Rules

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Registrar/Deputy Registrar

Counsel/Solicitors:
Victoria Casey QC, Wellington
Lindsay McKay, Barrister, Auckland
Chapman Tripp, Auckland
Crown Law Office, Wellington
Inland Revenue – Legal Services, Wellington

[1] This case concerns the depreciation rate for turbine halls at Mercury's Kawerau and Nga Awa Purua geothermal powerstations. (Nga Awa Purua is referred to by the rather less attractive name of NAP.)

[2] The issue in dispute is whether the turbine halls fall within the definition of "building" under the Income Tax Act 2007 (the Act) as the Commissioner states, and are therefore subject to a depreciation rate of 0%, or whether they are to be treated as part of the gantry cranes situated within the halls, and subject to a depreciation rate of 9.6%, as claimed by Mercury.

[3] That issue is reflected in Mercury's Notice of Proposed Adjustment (NOPA),[1] the statements of claim, the statement of issues in the parties' joint memorandum of 30 May 2017, and in the agreed summary of facts.

[4] The issue identified in Mercury's opening submissions (filed over a year ago), was materially different. However, it was ultimately, and helpfully, restated as above.

[5] The parties agree that if I find the turbine halls are not buildings, and also find they do not qualify for depreciation at the gantry crane rate, the case is to be adjourned so they can confer on what would be the appropriate description and depreciation rate of the turbine hall for tax purposes.

Background

[6] Mercury owns (or jointly owns) a number of geothermal powerstations. A geothermal powerstation is made up of a large number of structures, including a powerhouse, cooling tower, and steam separators. Annexure "A" is a photo of the NAP geothermal powerstation.

[7] The powerhouse, which forms part of each powerstation, incorporates a turbine hall and any attached annex housing electrical equipment and other plant.

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1 Dated 22 July 2016.

[8] The turbine hall (the focus of this case) houses the main generating plant (turbines, generators, and other equipment). It also houses a gantry crane, a large overhead crane suspended over the operating floor, which is critical for maintenance of plant and can move plant from one point in the hall to any other point. The crane is fixed to a support structure. Mr Brookie (Mercury's expert witness) describes this as a "braced box" made up of vertical, diagonal and horizontal beams. Its appearance is of bracing built into the walls and roof.

[9] Not all geothermal powerstations have a powerhouse/turbine hall. Amongst Mercury's geothermal powerstations, Kawerau and NAP both operate what is referred to as a "flash" process and have a powerhouse. Another powerstation at Ngatamariki operates what is referred to as a "binary" process and does not have a powerhouse. Binary turbines and generators in fact have to be outside. Rotokawa, to which I refer subsequently, operates both flash and binary processes and has a powerhouse to house its "flash" turbine and generator, while the binary turbines and generators are located outside.

[10] There is no material difference for purposes of this proceeding between the Kawerau and NAP powerhouse/turbine hall.

[11] Before 1 July 2011, there was no issue over depreciation treatment of the Kawerau and NAP geothermal powerhouses/turbine halls. They were depreciated as "structures (default class)" with an estimated useful life (EUL) of 50 years and a depreciation rate of 4%. The gantry cranes operating inside the turbine halls were included in the total amount capitalised for the powerhouse. This meant they were not separately depreciated and were depreciated as part of the "structures (default class)" at the rate of 4%. The foundation for the turbines and generators (known as the TG Foundation, which is set within the turbine hall, but is a separate structure) was also included in the total amount capitalised for the powerhouse and depreciated as part of the "structures (default class)" at the 4% rate.

[12] On 1 July 2011, the Taxation (Budget Measures) Act 2010 came into force (the 2010 Budget Act). That Act set the depreciation rate for buildings with an EUL of 50 years or more at 0% with effect from the 2012 income year, (and, although

not applicable here, for buildings with an EUL of less than 50 years at a rate of 1 divided by the EUL).[2] This change followed from a recommendation in the report of the Tax Working Group in 2010.[3] The change lead to the issue in this case. The gantry crane rate was set at 9.6% and the TG Foundation rate at 12%, the same rate as the turbines and generators. There is no issue over any depreciation rate except with regard to the turbine hall.

[13] Following the 2010 Budget Act coming into force, Mercury's self-assessment for the income years 2012-2015 was made on the basis that its geothermal powerhouses (including NAP, Kawerau and Rotokawa) should be apportioned on a below and above ground basis. It treated 70% of the powerhouse cost as below ground and classed as a depreciable "structure" with an EUL of 50 years and a depreciation rate of 4%. The remaining 30% of the cost was treated as above ground and classed as a "building" with an EUL of 50 years and a depreciation rate of 0%. Although there was an earlier suggestion to the contrary, the Commissioner confirms that she does not make anything of the position adopted by Mercury over that interim period, as compared to its current claim that the turbine hall as a whole should be treated as the gantry crane and subject to a single depreciation rate of 9.6%.

[14] The Commissioner's position was, and remains, that the depreciation rate for the turbine hall as a building with an EUL of 50 years, is 0%.

[15] Mercury, along with others in the electricity industry, negotiated at length with the Commissioner over the issue of the depreciation status of turbine halls (hydro, geothermal and thermal).

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2 Income Tax Act 2007, s EE28.

3 Victoria University of Wellington Tax Working Group *A Tax System for New Zealand's Future* (Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, January 2010). As recorded in the foreword, "The Tax Working Group (TWG) was established by Victoria University of Wellington's Centre for Accounting Governance and Taxation Research, in conjunction with the Treasury and Inland Revenue, in May 2009. Although an independent Group, it was formed with the support of the Minister of Finance, Hon Bill English, and the Minister of Revenue, Hon Peter Dunne. The Group's task was to identify the major issues that Ministers will need to consider in reviewing medium-term tax policy and to better inform public debate on tax."

[16] Taxpayers can seek provisional or special depreciation rates. They can seek a provisional rate where, for example, it is claimed that an item does not fit well within asset descriptions in the Commissioner's "General depreciation rates" publication (the depreciation table).[4] A provisional rate, if set, will apply to that item for all taxpayers. A special rate can be sought when a taxpayer considers a different rate should apply to their particular item because of the special use it is put to in their business. The special rate will apply only to that taxpayer.

[17] Following the electricity sector negotiations, in March 2015 the Commissioner issued "Provisional Determination PROV 26: Depreciation Rate for hydroelectric powerhouses", which provides that a hydro powerhouse has an EUL of 100 years and a provisional depreciation rate of 2%.[5]

[18] On 23 February 2016, the Commissioner issued "Provisional Determination PROV 27: Geothermal and thermal powerhouses".[6] It confirmed the Commissioner's position that geothermal powerhouses have an EUL of 50 years and a depreciation rate of 0%. The determination applied retrospectively back to the 2012 income year.

[19] Various IRD notices and assessments followed, leading ultimately to this hearing. It is unnecessary to go into detail about the process that has taken place, or the reason that there are two separate proceedings before me. The parties agree it is sufficient for me to answer the questions raised, which are the same in the two proceedings. The parties can take such subsequent procedural steps as are required.

[20] This is not an "appeal" against PROV 27. The parties have agreed that this hearing can in the first instance be restricted to the "in principle" question outlined at the outset. The proceeding is a challenge proceeding under Part 8A of the Tax Administration Act. The Court's role is to approach the issue on the merits and reach its own view on whether the position taken by Mercury or the Commissioner

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4 Inland Revenue *General depreciation rates* (IR265, April 2019) [the depreciation table]. Under s 91AAG of the Tax Administration Act 1994.

5 Provisional Determination PROV 26 Depreciation Rate for Hydroelectric Powerhouses (25 March 2015).

6 Provisional Determination PROV27: Geothermal and thermal powerhouses (23 February 2016).

is correct. To the extent my answers may impact on PROV 27, that will be a matter for the parties, and members of the electricity sector, to consider separately.

[21] The financial implications flowing from the different approaches to depreciation of the powerstation/turbine hall are considerable. The additional depreciation claimable by Mercury for the 2012–2015 years alone, if the turbine halls at NAP and Kawerau are held to be depreciable plant (gantry cranes) instead of buildings, is estimated at $7.4 million.

Order of inquiry and burden of proof

[22] Section DA 1 of the Act is the "general permission" that allows taxpayers to deduct depreciation loss. "Depreciation loss" is defined by reference to s EE 1(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
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> (b) the item is depreciable property, as described in sections EE 6 to EE 8; and
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> (c) the item is used, or is available for use, by the person in the income year; and
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> (d) the amount of depreciation loss is calculated for the person, the item, and the income year under sections EE 9 to EE 11.

[23] Ownership not being an issue, the first step is to identify the item and then to see if the item is of a type described in ss EE 6–EE 8. Sections EE 6(1) and (2) define "depreciable property" as property, inter alia, 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 carrying on a business for the purpose of deriving assessable income, and is not described in s EE 7. Section EE 7 confirms land is not depreciable, but buildings, fixtures, and certain listed improvements are depreciable if they meet the test in ss EE 6(1)–(2), and there is no dispute the turbine halls do meet the test. In this and all other respects, ss EE 1(2)(a)–(c) are not at

issue here. The issue is s EE 1(2)(d): what the amount of depreciation loss is under ss EE 9–EE 11.

[24] Sections EE 9–EE 11 are intricate. Suffice to say that their effect in this case is that if the item is a building with an estimated useful life of 50 years or more, then the depreciation rate is 0%.[7] If not, then the item will have the depreciation rate set under s EE 31(2)(a). This will either be the rate already set by the Commissioner in her depreciation table, or the rate obtained through applying for a provisional or special rate, as described earlier.

[25] Considering these provisions, the parties agree that the correct order of inquiry for determining the rate for depreciation loss (if any) in this case is the following:

(a) identify the item of property at issue;

(b) determine whether it is a building; and

(c) if it is not, determine what it is in terms of the depreciation table. As stated, I have only to decide at this point if the item is to be treated as part of the gantry crane. If not, the case is adjourned.

[26] The burden of proof is on Mercury as the taxpayer, to persuade me on the balance of probabilities at each stage of the inquiry. That is not disputed.

Question 1: What is the item?

[27] In closing submissions, the parties agree that the "item" to be considered is the turbine hall.

[28] The Commissioner's position is that the item is more accurately described as the powerhouse (turbine hall/electrical annex combined). However, Mercury has accepted the Commissioner's assessment of the electrical annex as a building

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[7] I note that is not the same, technically, as an item not being depreciable. Other depreciation provisions still apply.

with a depreciation rate of 0% and it is agreed that nothing turns on that, so for practical purposes the item can be referred to as the turbine hall.

[29] In its opening submissions, Mercury referred to there being three "items" or "civil elements" in question, comprising overall the "turbine hall". Those three elements are described as:

(a) *The gantry crane support structural system* comprising the vertical, horizontal and diagonal structural supports (including rail beams) for the gantry crane. This is the "braced box" referred to earlier, that might appear to a lay person inside the turbine hall to be the wall and ceiling framing.

(b) *The turbine hall base structure* comprising four floors or levels of the turbine hall, incorporating reinforced concrete slabs supported by a system of structural steel and below-ground foundations. This excludes the TG Foundation, which is a separate item.

(c) *The cladding system* comprising the clad outer shell (including roofing) of the turbine halls. This is essentially the exterior walls and roof.

[30] However, Mercury accepts that this breakdown has potential relevance only to its argument at the next stage of the inquiry (whether the item is a building) and that the "item" to be categorised for tax depreciation purposes is the turbine hall (excluding electrical annex and TG Foundation).

[31] It is clearly correct that there is only one item. The turbine hall is one structure (to use a neutral term) and therefore one item for purposes of this inquiry. As Richardson J said, in a slightly different context in *Commissioner of Inland Revenue v Waitaki International,* it would be totally unreal to suggest that walls, roof and floor could each take on a separate status.[8] The three "elements" here are

[8] *Commissioner of Inland Revenue v Waitaki International* [1990] 3 NZLR 27 (CA) at 31.

the walls incorporating the crane support system, the base structure comprising four floors, and the cladding system being the exterior walls and roof.

[32] Unsurprisingly, it is also clear from the evidence of Dr Brooke, (expert structural engineer for the Commissioner), and of Mr Brookie, (expert structural engineer for Mercury) that the three "elements" are integrated and interdependent. That is, they are part of one unit.

Question 2: Is the turbine hall a building?

[33] The next point of inquiry is whether the turbine hall is a building.

[34] For purposes of this judgment, the turbine hall excludes the TG Foundation, which is a specialised foundation for the turbines and generators, and a structure which is separated from the balance of the turbine hall, although contained within it. The Commissioner has assessed that structure as being plant and allocated it the same depreciation rate as the turbines and generators, which is not in dispute.

[35] Mercury does not dispute, or cannot realistically dispute for purposes of this hearing, that the turbine hall has an EUL of 50 years or more. Mercury's own design specification provided that the turbine halls have a physical/design life of 50 years or more. I note also that its project asset register specifically lists the turbine halls as having an EUL of 50 years.[9]

[36] As noted above, if the item is not a building, then I have to consider whether it is to be treated as a gantry crane in the depreciation table. A gantry crane has a depreciation rate of 9.6% being the economic rate fixed for that item.

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[9] There was some suggestion from Mercury in closing that it may be incorrect to say that the turbine halls have an EUL of 50 years or more, on the basis of earlier obsolescence of attached plant. Mercury says it was prevented from seeking a lower rate by s EE 35(2) of the Act. However, the clear position in terms of the record is as I have stated.

Relevant legislation

[37] The definition of "building" in the Act is exclusionary only. That is, it does not specify what a building is, but only what a building is not:[10]

> Building, in sub-parts EE and EZ, does not include – (a) a grandparented structure: (b) commercial fit-out.

[38] The definition insofar as it excluded grandparented structure was incorporated into the Act by the 2010 Budget Act.[11] The exclusion for commercial fit out was inserted later in 2010 by the Taxation (GST and Remedial Matters) Act 2010.[12] There was no definition of "building" prior to 2010.

[39] The Commissioner's overriding submission is that "building" in the Act is to be given its conventional meaning. She submits, and I agree, that some assistance in discerning the intended meaning can be gained from what is excluded from the definition, namely "grandparented structure", and "commercial fit-out", and also from the additional carve-out for "temporary buildings".[13]

[40] The definition of grandparented structure was added in the 2010 Budget Act. It is defined as meaning "barns, carparks (buildings), chemical works, fertiliser works, powder-drying buildings and site huts" acquired on or before 30 July 2009.[14] By logical inference, that would mean that any of those items, if acquired after 30 July 2009 would otherwise fall within the definition of building. That makes it reasonably clear that buildings would include industrial buildings and buildings that would be considered to be of a specialised industrial nature, as for example fertiliser works are. In fact, Mr McKay agrees that is the case.

[41] "Commercial fit-out" is defined as follows:[15]

> … means an item to the extent to which it is –

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10 Income Tax Act 2007, s YA 1 definition of "building".
11 Taxation (Budget Measures) Act 2010, s 96(2).
12 Section 132(4).
13 Taxpayers are permitted a deduction for loss incurred through the destruction of a temporary building under s DB 20 of the Act.
14 Section YA 1 definition of "grandparented structure".
15 Section YA 1 definition of "commercial fit-out".

(a) plant attached to a commercial building, but not used inside a dwelling within the commercial building:

(b) attached to, and non-structural in relation to, a building, if the item is not used for weatherproofing the building and –

(i) is not used in relation to, and is not part of, a dwelling within the building; or

(ii) is used in relation to, but is not part of, a dwelling within the building, and the building is a commercial building.

[42] "Plant" is again defined only by exclusion, as "[not including] an item that is structural in relation to a building".[16] This definition was also added by the Taxation (GST and Remedial Matters) Act 2010.

[43] "Commercial building" is defined as meaning "a building that is not, in part or in whole, a dwelling, unless the use as a dwelling is a secondary and minor use". This means that the "fit-out" provisions apply to all buildings other than dwellings, and therefore apply to industrial buildings. Again, I do not take that to be disputed.

[44] The combination of these provisions makes it clear that anything that is structural in relation to a building, even if it would otherwise be plant, is not plant. It is part of the building for depreciation purposes.

[45] "Temporary building" was defined in the Act since prior to the 2010 Budget Act, but was also amended by the Taxation (GST and Remedial Matters) Act 2010, and now reads:[17]

(a) [Repealed]

(b) a building that—

(i) is erected at a construction site; and

(ii) is to be demolished or removed on or before the completion of the construction; or

(c) a building that—

(i) was erected, and is used, to house specific plant or machinery; and

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16 Section YA 1 definition of "plant".
17 Section YA 1 definition of "temporary building".

(ii) will have to be demolished to remove or replace the plant or machinery

[46] This makes it clear that even structures erected and used to house specific plant and that are to be demolished once the plant is removed, would fall in the intended definition of building, but are purposefully excluded because they are only useful for the life of the plant.

[47] I should add here that it is also clear from the legislation that not every structure is a building. Industrial facilities such as powerstations have a range of structures of varying sizes and complexity. Some structures the Commissioner accepts are not buildings under the Act (for example, cooling towers) and they are depreciated in accordance with their specific EUL and depreciation rates set by the Commissioner and the Tax Administration Act 1994 and recorded in the depreciation table.

Ordinary and natural meaning

[48] Subject to the above legislative refinements, I consider that the question of what is a building for purposes of depreciation under the Act is to be approached as a general rule in terms of the ordinary and natural meaning of the word. That is the accepted approach to interpretation of a word or phrase in legislation where that meaning is consistent with the purpose of the provision, and there is no contrary indication in the legislation or elsewhere.[18] There is nothing in the legislation that gives any signal that a building for purposes of the depreciation provisions is anything other than a building in the ordinary sense of the word. It is also clear that what might otherwise be "fit-out" or "plant", if it is "structural" in relation to an (industrial) building, is part of the building and is not treated as plant or fit-out for depreciation purposes. On the other hand, plant merely attached to an industrial building is not included or treated as a building for tax purposes and can be separately treated as plant.

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[18] Interpretation Act 1999, s 5(1); *Stiassny v Commissioner of Inland* Revenue [2012] NZSC 102, [2013] 1 NZSC 453 at [23]; and *Terminals (NZ) Ltd v Comptroller of Customs* [2013] NZSC 139, [2014] 1 NZLR 121 at [39] per Glazebrook J.

[49] Mr McKay submitted in opening that a first possible line of reasoning to determine the meaning of building might be in accordance with the interpretation of building for purposes of the Resource Management Act 1990 and Building Act 2004. "Building" in those senses has a special and very broad meaning. Mr McKay did not of course promote that approach and it was not suggested by the Commissioner that it should be adopted. I need take that no further.

[50] In closing, Mr McKay accepts that, at least generally, the common meaning of building would apply.

[51] In 2009, before the enactment of the 2010 Budget Act, the Commissioner issued an interpretation statement on the meaning of "building".[19] The Commissioner examined the meaning through the legislation, case law and dictionary sources, and came to the following common description of "building":

(a) A building is a structure of considerable size.

(b) A building is permanent in the sense that it is designed to be located permanently on the site where it stands. A building is fixed to the land on which it stands. However, a building need not be legally part of the land on which it stands.

(c) A building is enclosed by walls and a roof.

(d) A building can function independently of any other structure. However, a building is not necessarily a physically separate structure.

(e) The appearance and function of the structure are relevant in determining whether a structure is a building for depreciation purposes (that is, whether the structure looks like the conventional idea of a building and is designed for the uses to which conventional

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[19] Inland Revenue *Interpretation Statement IS 10/02: Meaning Of "Building" In the Depreciation Provisions* (IS 10/02, 30 July 2009).

> buildings are ordinarily put). It is appropriate to ask whether a reasonable person would regard the structure as a building.

[52] Without examining in detail the cases and other sources the Commissioner used to come to this definition, I consider it is a good working definition of building. Not all of these indicia need be present in each case. For example, a carpark building often does not have a roof.

[53] The Courts have said that the hypothetical view of the reasonable lay observer is useful. Ms Casey QC refers to what she termed "the duck test":[20]

> "Building", however, is an ordinary English word, and in this statute should be given the meaning an ordinary person would attribute to it. What we have in this case looks like a building. It is almost identical to its neighbouring structure, which is admittedly a building. It is built like a building. It is used like a building. … The only reasonable conclusion, in my view, is that it is a building.

[54] The turbine hall certainly looks like a building from the outside, as can be seen from the photo of the NAP powerstation in Annexure "A".

[55] In his oral closing submissions, Mr McKay accepts that on a "first blush" basis, applying the common meaning test, the reasonable observer would consider that the turbine hall is a building at least on the basis of its external appearance.

[56] Mr McKay stresses that I have to look both inside and outside the turbine hall.

[57] Having viewed numerous photos of both, and applying the reasonableness test, I consider a reasonable observer looking both from inside and outside the turbine hall would say it is a building. It fills the function of a building in the sense of enclosing and housing something, in this case a substantial amount of plant. It has doors, hallways and large floor areas for people (generally in small numbers) to work and move around in, and to enable placement and movement of plant. I consider it meets all of the criteria I described above.

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[20] *Metals & Alloys Co v Ontario Regional Assessment Commissioner* (1985) 36 RPR 163 at 50.

[58] Mr McKay says I should place low priority on the reasonable observer "test" in this case. I disagree that such a common sense approach should be given low priority. Asking what a reasonable observer would say seems to me to be another way of determining whether something is a building in its ordinary and natural meaning. However, I accept the matter does not end there. The above factors, including the reasonable observer test, are not determinative. They are factors to be considered, but the matter is more nuanced.

The Waitaki factor

[59] Mr McKay relies on a line of cases where a structure that an ordinary person would or might say was a building was held not to be – or at least was held to be "plant".

[60] As Mr McKay puts it, such cases will not be common. He relies in particular on what he refers to as the leading New Zealand case of *Commissioner of Inland Revenue v Waitaki International Ltd*.[21] In that case, the taxpayer claimed a deduction for the cost of installing insulating panels on its cold-store buildings. The taxpayer used the panels to construct the interior and exterior walls and roofs of these buildings. At issue was whether these new structures were "plant". The Court of Appeal wrote:[22]

> The crucial question then as I see it is whether a cold-store or freezer is to be characterised as a highly specialised setting for the business operations, or whether the building itself plays a significant part in the industrial operations. If the latter is its function then it is plant.
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> (Emphasis added)

[61] The Court of Appeal held that the structures went beyond a mere setting for plant, and that the structures were part of the "apparatus" of the refrigeration process, so were plant.[23]

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21 *Commissioner of Inland Revenue v Waitaki International* [1990] 3 NZLR 27 (CA).
22 At 31 per Richardson J.
23 At 36 per Richardson J.

[62] While Mr McKay describes *Waitaki* as the leading case in New Zealand, he also acknowledges it is probably the only New Zealand case on point.[24] Further, while involving a similar point to the present, it is in a different tax context, the question in *Waitaki* being whether the taxpayer should receive a deduction for expenditure on plant, not application of the depreciation regime.

[63] The other cases cited by Mr McKay are also not in relation to depreciation, and come are from other tax jurisdictions.[25] I am not sure in any event that they add anything to *Waitaki*.

[64] Mr McKay places particular emphasis on the decision of the House of Lords in *Barclay Curle*.[26] Pursuant to the United Kingdom tax legislation at the time, "industrial buildings" qualified for a certain level of capital allowances, and "machinery and plant" for an allowance of twice as much. The issue before their lordships was whether a dry-dock constructed by the taxpayer adjacent to the River Clyde was "plant". By majority they found the dock was plant. In his judgment, Lord Reid cited with approval the findings of the Special Commissioners (the first instance decision makers):[27]

> The dry dock was in our view not the mere setting or premises in which ships were repaired. It was different from a factory which housed machinery, for in the operation of the dock, the dock itself played a part in the control of water and enabled the valves, pumps and electricity generator, which were an integral part of its construction, to perform their functions. The dock was not a mere shelter or home but itself played an essential part in the operations which took place in getting a ship into the dock, holding it securely and then returning it to the river.

[65] From these cases, Mercury distils a number of propositions, which I summarise:

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24 Mr McKay also cites *Lake Pine MDF Ltd v Commissioner of Inland Revenue* (1994) 16 NZTC 11,001 (HC), but this case is not about the distinction between a building and plant.

25 *Broken Hill Property Co Ltd v Federal Commissioner of Taxation* (1968) ATD 43 (HCA); *Inland Revenue Commissioners v Barclay Curle* [1969] 1 WLR 675 (HL); *Schofield v R and H Hall Ltd* (1974) 49 TC 538 (CA NI); *Wangaratta Woollen Mills Ltd v Federal Commissioner of Taxation* (1969) 119 CLR 1 (HCA).

26 *Inland Revenue Commissioners v Barclay Curle* [1969] 1 WLR 675 (HL).

27 At 678.

(a) Whether a structure is plant is to be determined by reference to the structure as a whole and the relationship of that structure to both the operations carried on within it, and to the "operating" plant with which those operations are performed.

(b) If that relationship only involves the structure providing no more than an appropriate or convenient setting for the relevant activity, the structure will not be plant.

(c) Commercial structures will highly likely be no more than settings, and so not plant.

(d) It is only when a structure is materially integrated with the "operating" plant and equipment within it, or with the industrial process carried on within the structure, that the structure becomes, itself, plant.

[66] The Commissioner's position is that the cases cited by Mercury have no place in the current depreciation context because it is governed by a specific statutory regime that is different from those in the cases referred to, both in terms of jurisdiction and in terms of context.

[67] When considering the meaning of "building" in her interpretation statement, the Commissioner addressed the type of cases relied on by Mercury and concluded that structures that are specialised in the sense of the setting they provide or their function or integration with plant or equipment are also buildings, effectively the question I am considering here. The Commissioner submits that because Parliament was aware of her interpretation statement when it enacted the 2010 Budget Act, and did not directly contradict it in the enacted definition of building, it must have been or should be taken to accept the Commissioner's interpretation as correct. I do not accept this submission. I consider it would go too far to infer an endorsement of the Commissioner's reasoning from the lack of a positive definition in the Act, or the provisions that were included.

[68] Ms Casey stresses that the core concept in the depreciation regime is the EUL of the item, which is a question of fact. Depreciation rates are set to reflect the EUL. Buildings with a life of 50 years or more are by law now allowed no deduction. It is accepted that the turbine halls have an EUL of 50 years of more. The Commissioner submits that categorisation of them as buildings is therefore entirely consistent with the depreciation regime.

[69] Ms Casey also refers to the Court of Appeal's decision in *Queenstown Airport Ltd v Commissioner of Inland Revenue* which she advises me is the only case under the current depreciation regime.[28] I agree it is material in terms of principle.

[70] The issue in *Queenstown Airport Ltd v Commissioner of Inland Revenue* concerned whether a grassed area at the end of a runway, used as a safety area, could be classed as "runway" for depreciation purposes.

[71] The Court said the policy underlying the current depreciation rules in the Act is to allow for deduction of the cost of depreciation, and that the purpose of the depreciation regime is to recognise the fact that assets wear out and must eventually be replaced and to allow the capital cost of the asset to be written-off progressively over its life where it is a business asset.[29]

[72] Ms Casey submits that the corollary, put simply, is that if a taxpayer asserts that something is an item that has a depreciation rate which is greatly inconsistent with its actual EUL, then that is a clear signal that the taxpayer's interpretation is inconsistent with the purpose of the depreciation regime. That must be correct.

[73] I note further that particular care needs to be taken around the integration of plant into something that otherwise appears to be a building. The House of Lords confirmed in *Inland Revenue Commissioners v Scottish Newcastle Breweries Ltd*, following the line of cases initiated in *Yarmouth v France*, that items that might otherwise be plant but are integrated into the fabric of the building (such as

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28 *Queenstown Airport Corporation Ltd v Commissioner of Inland Revenue* [2017] NZCA 20, [2017] 2 NZLR 811.

29 At [45].

electrical wiring) are generally not to be considered plant.[30] The Court further confirms that exceptions to that principle are rare:[31]

> Moreover the test accepted in this case by the commissioners and affirmed by the Inner House draws a line which can be held without trouble: something which becomes part of the premises, instead of merely embellishing them, is not plant, except in the rare case where the premises are themselves plant, like the dry dock in *Barclay Curle*.

[74] That position is legislated for and extended in the fit-out provisions in the Act.[32]

[75] While I do not agree with Ms Casey that the case law has no place in this context, I do agree that the provisions in the legislation on what is not a building, and the policy underlying the regime, should lead to a cautious approach in applying the principle in *Waitaki*.

[76] However, I consider that in those rare situations where a building is part of the apparatus for carrying on a business, it might be considered for purposes of the depreciation provisions of the Act to not be a building. Interestingly, that language is similar to the language the Commissioner used in PROV 26 when she said a hydro turbine hall is "integral to the function of the production of hydropower".[33]

[77] Mercury's evidence seems to have been closely modelled on an "integration" concept, perhaps borrowing from the language used in PROV 26. Mercury relies (particularly) on Mr Brookie's evidence, which is as follows:

> In my opinion and experience, all of the turbine halls' civil and plant systems are fundamentally integrated with one another. The plant cannot exist, operate, be serviced or maintained without the civil systems. The only reason the civil systems exist is to support the operation, service and/or maintenance of the major and secondary plant in the turbine hall. The major plant – the turbine, generator and condenser – are the most crucial pieces of equipment required to generate electricity. The secondary plant and the civil systems play a supporting, but no less essential role because without them the power station would not function.

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30 *Inland Revenue Commissioners v Scottish Newcastle Breweries Ltd* [1982] 2 All ER 230 (HL) at 328 per Lord Lowry; and *Yarmouth v France* (1887) 19 QBD 647.

31 At 332 per Lord Lowry.

32 See the discussion at [37]–[47].

33 A ruling such as PROV 26, though binding on the Commissioner, does not have other legal effect.

> The functions and dimensions of the major plant drives the function and dimension of literally every other plant item, which in turn defines the function, the geometry and load-carrying requirements of the other system, including the civil systems.
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> So, to my mind, the disputed civil systems in the turbine hall are very much as core to the overall power station as the plant systems. That is really the main point I wish to make in my evidence. It is the key point which falls out of what Mercury's solicitor have asked me to do.

[78] Under cross-examination, Mr Brookie clarified the above passages to say all the plant works together. He said what he means by "integration" is not that the turbine hall (or its "civil elements") and its plant are physically touching, but that they are interrelated and interconnected: one sits with the other comfortably and is supported by the other. He added that this is an industrial process and it all works together. He agreed this is typical of any industrial process and that he was not trying to say anything more than that. He accepted that the plant and turbine hall were physically distinct; that is if you took the plant out, the roof, walls and cladding of the turbine hall would remain.

[79] I found Mr Brookie's evidence quite vague in terms of Mercury's "key point". My sense was that in his evidence-in-chief he was trying to stretch his description as far as possible to fit the argument, without I might add being in any way misleading – hence his ready agreement with Ms Casey's propositions.

[80] I consider Mr Brookie's "key point" can be fairly summed up as being that the plant and the turbine hall sit with each other comfortably and are supported by each other. On that basis, it all works together, as is typical of any industrial process.

[81] However, I consider this falls well short of the position in *Waitaki*. The turbine hall providing "support" for machinery is quite different to its being an integral part of the production process to such a degree that it can be treated as plant.

[82] The particulars on which Mr Brookie relies, not surprisingly given his answers in cross-examination, do not take the matter much further. I consider some of these particulars below.

[83] Addressing Mercury's first two "civil elements" of the turbine hall,[34] Mr Brookie refers to the walls being reinforced to support the gantry crane and the floor reinforced to support the equipment sitting on it. But this is not exactly out of the usual for industrial buildings. The gantry crane itself is used (post construction of the turbine hall) for maintenance, and is not part of the actual production process. The turbine hall serves a materially wider range of uses than supporting the crane. I accept Dr Brooke's evidence that the crane rails and associated corbels are the only components with the sole purpose of supporting the crane and that the great majority of the steel work in the turbine hall serves multiple purposes including resisting forces generated by the weight of the crane, the weight of the turbine hall, the wind acting on it and earthquakes. The reinforced floors are used for many and general purposes. The position with the four floors is materially different from the TG Foundation, which the Commissioner has assessed as "plant".

[84] Addressing Mercury's third "civil element", there is nothing about the cladding (exterior walls and roof) of the building that is integral to the production process. (In fact, Mercury advanced considerable evidence as to the cladding being unnecessary. That line of reasoning was difficult to follow as the cladding forms a material part of the structure which has been built to Mercury's design requirements and at considerable cost. That submission seems to have been dropped in closing.)

[85] The need for the turbine hall to meet certain length, height and other specifications to house all the machinery does not go to the hall's being integral to the production process, and again would be a not uncommon dictate for industrial buildings.

[86] As I have said, Mercury has not persuaded me that this is one of those rare cases where the structure (the turbine hall) is part of the apparatus of the business.

[87] The other possible proposition, to be taken from cases such as *Barclay Curle*, is that where a structure has no other possible use, it is not, or may not be a building. I am not sure this is in fact part of the ratio of the House of Lords decision in *Barclay Curle*, but it has been cited that way. I did not take Mercury to press this

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[34] To use Mr Brookie's language, referring to the elements described above at [29].

point as a separate argument, but the issue seemed to be raised quite frequently during the hearing.[35]

[88] On the basis that alternative use options can be an indicia of whether something is a building, the Commissioner put up evidence from Mr Geoghegan[36] of two out of three obsolete thermal powerstations (New Plymouth and Meremere) being repurposed. One is used as a dry-store. The other is apparently still used as an industrial-grade recycling plant. Mr Geoghegan said that there is similarity in construction between a thermal powerstation and the "flash" geothermal turbine halls, so I infer that such alternative uses could be possible for the two turbine halls involved here. In any event, I have no evidence to the contrary.

Other considerations

[89] Mercury places considerable emphasis on the depreciation treatment of hydro powerhouses, covered in PROV 26. It submits there is no material distinction between a hydro powerhouse and a geothermal powerhouse, and points to comparisons with the Aratiatia hydro powerhouse. PROV 26 is not law such that I could apply it. Further, I do not have the information I would need to draw a meaningful comparison between hydro powerhouses generally and geothermal powerhouses generally, regardless of what reliance I could place on PROV 26. Mr Geoghegan gave evidence that there are 36 hydrostations in New Zealand and it is undisputed that Aratiatia is unusual in that it is not sited in a river.[37]

[90] I would add that it strikes me there are likely some material differences between hydro and geothermal powerhouses, including that most hydro powerhouses are situated in rivers and have water flowing through them, or part of them. They are attached to the dam itself. This would tend to suggest that the hydro powerhouse would fall into the limited category of structures that are integrally involved in the production process, similar to the cool store and dry dock examples.

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35 Mercury notes for example that the turbine halls would be very expensive to re-purpose, particularly given the surrounding plant, and that Mercury is required to remediate the properties should electricity generation cease.

36 An independent consultant with experience in the electricity generation industry.

37 Mercury's Chief Financial Officer, Mr Meek, accepted this.

[91] Finally, I note that the Commissioner places some emphasis on Mercury's treatment of its turbine hall at Rotokawa as a "building" for which 0% depreciation is claimed. The Commissioner says Mercury's tax treatment is inconsistent given Dr Brooke's evidence that the three turbine halls (Kawerau, NAP and Rotokawa) have the same material structural features. Mr Meek said that Rotokawa is different to Kawerau and NAP because the turbine hall is smaller, and there is a much lower level of complexity and integration between the plant elements and the crane structure at the Rotokawa site. However, I agree with the Commissioner that this evidence cannot be given any weight as Mr Meek does not have the appropriate expertise. I agree that on the face of the evidence Mercury's tax treatment of the three turbine halls would appear to be inconsistent. However, as I advised Ms Casey, I am not prepared to put any weight on this point.

Conclusion

[92] The turbine halls are buildings in the ordinary sense of the word, and *Waitaki* can be distinguished. This is not one of those relatively rare cases where a structure is part of the apparatus for carrying on a business, or so integral to the production process itself, that it should properly be classified as "plant".

[93] Therefore, I find that the turbine halls at the Kawerau and NAP geothermal powerstations (excluding any annex and the TG Foundation) are "buildings" for purposes of the depreciation provisions of the Act.

[94] Given my finding, it follows that I do not agree that the turbine hall can be classified as a gantry crane for depreciation purposes.

[95] I reserve leave for the parties to return to the Court should that be necessary.

[96] Costs are also reserved. I expect parties such as Mercury and the Commissioner will be able to resolve costs themselves. If not, the Commissioner should file a memorandum within 21 days and Mercury seven days afterwards.

Hinton J