

Clarifying the acquisition date of land

An officials' issues paper

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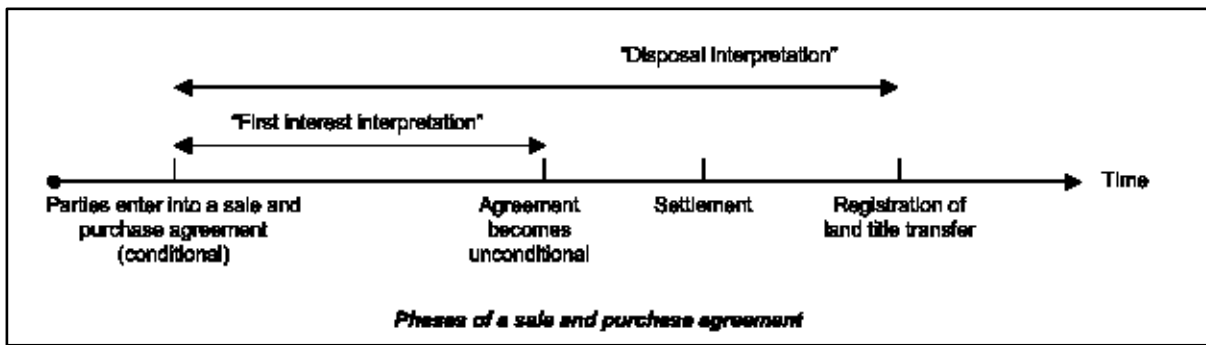
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CHAPTER 1

Introduction

- 1.1 A key element of an efficient tax system is certainty. That means a person's liability for tax should be as clear and as certain as possible, especially in New Zealand where the tax system is based on self-assessment. This issues paper focuses on the taxation of land disposal provisions in the Income Tax Act 2007, in particular section CB 6, which is causing some considerable uncertainty for taxpayers, their agents and Inland Revenue.
- 1.2 Section CB 6 deals with land acquired for the purpose of, or with the intention of disposal, and the taxation of income derived from disposing of the land. If a taxpayer acquires the land with the intention or purpose of disposal and subsequently disposes of the land, any profit made from the disposal is taxable.
- 1.3 The uncertainty is caused by the timing of when the taxpayer's intention or purpose should be determined. The Courts have held that intention or purpose should be tested when a taxpayer has acquired the land in question (known as the date of acquisition). However because the definition of "land" in the Income Tax Act 2007 includes estates and interests in land, and the taxpayer acquires different interests and estates in "land" at different times under a typical sale and purchase agreement, which are then merged when the title is registered, neither the legislation nor common law have provided sufficient clarity over which interest in "land" the date of acquisition should apply to.
- 1.4 As a result, taxpayers may be unable to self-assess whether gains made from a disposal of land should be returned as taxable income. Often taxpayers are only made aware of a tax liability as a result of an Inland Revenue audit.
- 1.5 There are two possible ways of interpreting section CB 6:
 - The "first interest interpretation" whereby the date of acquisition is the date when the first interest (equitable or legal) in land arises under an agreement for the sale and purchase of land (the "first interest" interpretation). Under this interpretation the date of acquisition is likely to be either the date the sale and purchase agreement is entered into or the date when the conditions of the agreement are fulfilled (that is, the purchaser is able to enforce the agreement).
 - The "disposal" interpretation whereby the date of acquisition is dependent on the interest or estate that is disposed of and when the taxpayer acquired that particular interest or estate in land. This can occur at any point in the agreement.
- 1.6 There are potentially numerous dates of acquisition in each interpretation, as shown in the following diagram.



- 1.7 The two different interpretations have sometimes resulted in taxpayer uncertainty about which date to apply to their land transaction(s) and, in some cases, unintended tax outcomes. This can be a particular problem when land has been purchased off the plans and the land title has not yet been registered. This is exacerbated if agreements for the sale and purchase of land span a number of months or years or if the interest in land is assigned or disposed of to another person before the title transfer is registered.
- 1.8 From a tax policy perspective, the “first interest” interpretation, whereby the intention or purpose of the taxpayer is tested on the date the first interest (equitable or legal) arises in a sale and purchase agreement, is the preferred interpretation as it results in greater certainty and therefore is more economically efficient. It is the initial decision-making that informs how a person intends to use the property, and it would be unusual for a property speculator to enter into a sale and purchase agreement unless they thought it very likely that the purchase and its subsequent disposal would be profitable.
- 1.9 This issues paper discusses:
- the reasons for the “first interest” interpretation being preferred over the “disposal” interpretation;
 - the arguments for and against the possible phases that the date of acquisition could be set at in the first interest interpretation (either when the agreement is entered into, or the agreement becomes unconditional and the purchaser can seek enforcement of the agreement); and
 - whether further guidance is needed on evidential issues that may arise due to the date of acquisition falling at the earlier phases of a sale and purchase agreement.
- 1.10 It is acknowledged that if the Government chooses to clarify the date of acquisition, taxpayers will have the opportunity to alter their behaviour under either interpretation to avoid evidence of having an intention or purpose of resale. It may also capture some taxpayers for whom the policy is not intended. However, this risk already exists under the current legislation and if the legislation is sufficiently clarified, greater transparency should benefit all parties.
- 1.11 As mentioned above, this issues paper focuses on section CB 6 of the Income Tax Act 2007 however, the date of acquisition affects most of the land provisions in subpart CB. Therefore clarifying the date of acquisition in section CB 6 will be a positive step towards clarifying most of the land

taxing provisions in sections CB 7, CB 9, CB 10, CB 14, CB 15, CB 18 and CB 19.

Suggested options

1.12 This paper suggests two possible options for determining a date of acquisition, based on events/phases of an agreement for the sale and purchase of land – either:

Option 1 when an agreement for the sale and purchase of land is entered into; or

Option 2 when an agreement for the sale and purchase of land becomes unconditional and the equitable remedy of specific performance of the land transfer is available to the purchaser.

1.13 We welcome views on these two options and also whether a legislative amendment is needed that allows for evidence presented before and after the date of acquisition to be considered when determining what the taxpayer's intention was on the date of acquisition.

Application date

1.14 For ease of administration and in the interests of fairness, if the Government does decide to clarify the date of acquisition following feedback on the options presented here, we suggest that the date of application for any legislative option (that is, for new acquisitions as opposed to new disposals) be prospective from the date of Royal assent of the relevant tax bill.

Submissions

1.15 You are invited to make a submission on the proposed reforms and points raised in this issues paper. Submissions should be addressed to:

Clarifying the acquisition date of land
C/- Deputy Commissioner, Policy and Strategy
Inland Revenue
PO Box 2198
Wellington 6140

1.16 Or email policy.webmaster@ird.govt.nz with "Clarifying the acquisition date of land" in the subject line.

1.17 Electronic submissions are encouraged. The closing date for submissions is 28 June 2013.

1.18 Submissions should include a brief summary of major points and recommendations. They should also indicate whether the authors would be happy to be contacted by officials to discuss the points raised, if required.

- 1.19 Submissions may be the subject of a request under the Official Information Act 1982, which may result in their release. The withholding of particular submissions on the grounds of privacy, or for any other reason, will be determined in accordance with that Act. Those making a submission who consider there is any part of it that should properly be withheld under the Act should clearly indicate this.

CHAPTER 2

Background

- 2.1 Subpart CB of the Income Tax Act 2007 contains provisions that deal with the taxation of income from the disposal of land. In particular, section CB 6 deals with land acquired for the purpose of or with the intention of disposal, and the taxation of income derived from the disposing of the land. Therefore if a taxpayer acquires the land with the intention or purpose of disposal and subsequently disposes of the land, any profit they make from the disposal is taxable.
- 2.2 The legislative history of section CB 6 is lengthy, as the profits made from the sale or disposition of real property were first considered to be a source of “business income” in the Land and Income Assessment Act 1891. The Appendix to this paper provides further background information on the history and treatment of this provision.
- 2.3 The policy intent of this section is to capture property speculators, who can be described as persons who buy and sell land with the intent or purpose of making a profit without necessarily developing or improving the land, and relying instead on chance, trend or volatility of the property market to provide financial gain.
- 2.4 This was clarified in Hansard when the Land and Income Assessment Act 1908 was amended by the Land and Income Assessment Amendment Act 1912:¹
- This is not an alteration in the law, but for the purpose of making the present Act clearer. Persons who speculate in land are liable to assessment for income tax on the profits from buying and selling the land.
- 2.5 The key distinction between section CB 6 and a capital gains tax is the subjective element, as the tax burden only falls on those who have the necessary intention or purpose to use land as if it were a trading asset. In this way the section attempts to distinguish between those who hold land as a capital asset and those who hold it as a revenue item. The economic rationale is that if a person is consciously transacting so as to make gains from buying and selling land without being taxed on these gains, it would be inefficient for them to divert work effort away from taxable activities towards this task.
- 2.6 Although this issues paper focuses on section CB 6, the date of acquisition affects most of the land provisions in subpart CB. Therefore clarifying the date of acquisition will also increase certainty in relation to most of the following land-taxing provisions:
- section CB 15 clarifies when land is acquired by associated persons for most of the land provisions in subpart CB;
 - sections CB 7, CB 9, CB 10, and CB 14 clarify when the 10-year period begins for a business dealing in land (including land

¹ (29 August 1912) 159 NZPD 624.

- development, subdivisions, and change of land under the Resource Management Act 1991); and
- sections CB 18 and CB 19, which clarify when land is acquired for the purposes of the residential and business exemption.

The issue: applying different dates of acquisition

2.7 The uncertainty this issues paper seeks to address is caused by the timing of when the taxpayer’s intention or purpose should be tested. The Courts have held that the relevant time for determining a taxpayer’s purpose or intention is at the time the taxpayer acquired the land.²

The appropriate time at which to consider a taxpayer’s intention or purpose under this provision is the date of its acquisition of the land.

2.8 However there is minimal case law to provide sufficient guidance on when acquisition actually occurs.

2.9 The tax case *Beetham v CIR* held that land is acquired when the parties to an agreement become bound by the contract to purchase and to sell that is, when the contract becomes unconditional, and an order for specific performance of the land transfer is available.³

2.10 However *Bevin v Smith*, a non-tax case held that under the general law a purchaser acquires an equitable interest in land if specific performance in its wider sense (for example, caveat or damages) is available to protect the purchaser’s rights under the contract.⁴ Specific performance in this case means all the equitable remedies are available to protect the interest of the purchaser under the contract, so it is a question of whether equity will, by injunction or otherwise, prevent the vendor from dealing with the property in a way that is inconsistent with the contract of sale.

2.11 The interpretation of these two cases (and those that followed) has resulted in a number of differing views over when land is acquired.

2.12 Furthermore because the definition of “land” in the Income Tax Act 2007 includes estates and interests in land, and the taxpayer acquires different interests and estates in “land” under a typical sale and purchase agreement which are then merged when the title is registered, neither the legislation nor common law have provided sufficient clarity over which “land” the date of acquisition should apply to.

Possible interpretations of section CB 6

2.13 There are two reasonable interpretations of this section. The first is that the date of acquisition is the date when the first interest (equitable or legal) in land arises under an agreement for the sale and purchase of land (the “first interest” interpretation). The date of acquisition would therefore fall in one of the initial phases of a sale and purchase agreement, either:

² *Anzamco Ltd (in liq) v CIR* (1983) 6 NZTC 61,522 (HC).

³ 72 ATC 6042, see also *Case Y3* (2007) 23 NZTC 13,028, *Annalong Pty Ltd v FCT* 72 ATC 4141.

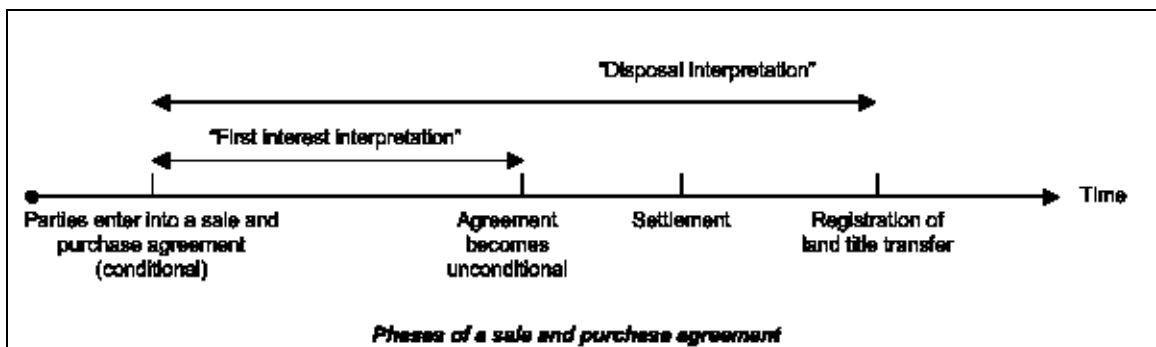
⁴ [1994] 3 NZLR 648.

- the date the agreement was entered into (even if the agreement was still conditional); or
- the date when all the conditions of the contract had been fulfilled and the purchaser can seek an order from the Court requiring the specific performance (that is the transfer of the land title) of the agreement (most commonly known as when the agreement goes “unconditional”).

2.14 A different interpretation is when the date of acquisition is determined by the “land” that is being disposed of (the “disposal interpretation”). Here, the date of acquisition would fall on the date the taxpayer acquires the interest or estate that is then subsequently disposed of. This can occur at different times under the agreement depending on how “disposal” is interpreted, but is more than likely to be the later phases of a sale and purchase agreement, that is either settlement or registration or in the alternative the date the agreement goes unconditional. For example:

- If the taxpayer, after acquiring a legal fee simple estate, subsequently disposes this legal fee simple estate, the land is acquired when the legal fee simple estate (the title transfer) is registered by the Registrar-General of Lands under the Land Transfer Act 1952. It is only at this time the taxpayer is able to deal with the land in an absolute sense and is able to dispose of the land, or alternatively, create new interests in land.
- If the taxpayer disposes of a lesser interest – for example, a legal easement, the date of acquisition is when the legal fee simple is acquired by the taxpayer. As described above, this date is when the land title is registered.

2.15 The following diagram illustrates and explains the different phases of a typical sale and purchase agreement.



The basic four phases of a sale and purchase agreement are:

Conditional agreement – when the contract is entered into, an equitable interest is created in favour of the purchaser. Specific performance in the wide sense (injunction, caveat or otherwise) is available to prevent the vendor dealing with the property inconsistently with the contract.

Unconditional agreement – with the exception of the payment of the purchase price, any conditions of the agreement (such as finance, solicitor’s checks and other findings, building report and LIM reports) have been fulfilled. The equitable remedy of specific performance in the “narrow sense” (an order requiring the transfer of title) is available to the purchaser.

Settlement – purchaser either pays, gives or makes available the purchase price to the vendor and there is a conveyance of the title to the purchaser.

Registration of title – documentation evidencing the purchaser’s right to the legal estate is registered under the Land Transfer Act, an act conferred by the Registrar-General of Lands and the legal estate is acquired by the purchaser.

Note:

- The time periods between the phases may vary.
- When an agreement is subject to “true conditions precedent”, a binding agreement will not be formed until the conditions are satisfied. An agreement that contains “conditions subsequent” is a binding contract.

2.16 These two interpretations have resulted in taxpayer uncertainty over which date to apply to their land transaction(s) and, in some cases, has had unintended tax outcomes. This has been a particular problem in situations when “land” is bought off the plans and a land title has not yet been registered.

2.17 The uncertainty in the law is also exacerbated by the fact that agreements for the sale and purchase of land may span over a number of months or years, and interests in land can be assigned to another person before the purchaser’s name is registered on the title.

- 2.18 The following example shows how the tax outcomes may differ depending on the interpretation that is applied.

Example A

Tom and Sally are nearing retirement. They decide to sell their Christchurch house and retire in Tauranga. They buy a house off the plans in a new subdivision in Tauranga and enter into a sale and purchase agreement with Peter the developer. The sale and purchase agreement for the Tauranga house is conditional on their Christchurch house being sold and the Tauranga house being completed.

Six months later, Tom and Sally enter into a sale and purchase agreement for their Christchurch house, this agreement is conditional on the Christchurch buyer receiving finance. Shortly after, the Christchurch buyer receives finance, and the Tauranga house is completed. However, before settlement of the Tauranga house occurs, Tom is diagnosed with cancer. Tom and Sally re-evaluate their circumstances and decide to move to Wellington for Tom's treatment and to be closer to family members. Tom and Sally re-advertise the Tauranga house through Peter the developer in the hope of finding a buyer.

Fortunately, Tom and Sally are approached by Rachael, who is keen to buy a house in the new Tauranga subdivision. Rachael enters into an agreement with Tom and Sally to purchase the Tauranga house as soon as the title is transferred from Peter. Tom and Sally stand to make a \$5,000 profit, due to increasing property values and high demand in the Tauranga area.

Settlement of the Tauranga house occurs and the title is simultaneously transferred and registered from Peter, to Tom and Sally, and then to Rachael.

Potential tax treatment under "disposal" interpretation

The land disposed of is the legal estate in fee simple. This interest is acquired when the title transfer is registered from Peter to Tom and Sally. Tom and Sally's intention or purpose on this date is to dispose of the Tauranga house to Rachael therefore the \$5,000 profit will be subject to tax.

Potential tax treatment under "first interest" interpretation

Tom, Sally and Peter did not have any conditions precedent in their sale and purchase agreement that indicated the parties did not intend to be bound by the contract at the time it was entered into. Therefore, under this interpretation an equitable interest has arisen in favour of Tom and Sally on the date they entered into the sale and purchase agreement for the Tauranga property. Tom and Sally's intention or purpose on this date was to live out their retirement in the Tauranga property. Therefore, their \$5,000 profit will not be subject to tax.

Preferred interpretation from a tax policy perspective

- 2.19 A fundamental consideration of a coherent, broad-base, low-rate tax system is that taxes should be efficient through minimising distortions and impediments to economic growth. This “efficiency” consideration also needs to be weighed against the opportunity for tax planning and providing a sustainable revenue base for the Government.
- 2.20 It is acknowledged that if the Government chooses to clarify the date of acquisition, taxpayers will have the opportunity to alter their behaviour under either interpretation to avoid evidence of having an intention or purpose of resale, or may capture some taxpayers for whom the policy is not intended. However, this is a risk that already exists under the current legislation and if the legislation is sufficiently clarified, greater transparency should benefit all parties.
- 2.21 We consider that a “first interest” interpretation is the most appropriate interpretation from a tax policy perspective and results in greater certainty and economic efficiency than the “disposal” interpretation, for the reasons discussed below.

Increase in land value and certainty of tax liability

- 2.22 A person’s intention regarding the land may change between the date the agreement was initially entered into and a subsequent date, such as the date of registration. This concern is illustrated in the example above. If the person’s intention is to purchase the property for resale, a “first interest” interpretation means that it is clear from the outset that any subsequent increase in value will be taxable.
- 2.23 A “disposal” interpretation, on the other hand, means that a person must wait until a later date (for example, registration) to determine whether the land is revenue-account property. They must account for tax not only on asset appreciation going forward, but also any increase in value in the past – between entering the contract and the date of registration. There could also be an argument that it should only be from the date the intention was changed.

Distortion of behaviour and the lock-in effect

- 2.24 As noted above, the choice of interpretation can also lead to behavioural distortions. Under the “disposal” interpretation, a person desiring certainty may delay entering into a sale and purchase agreement until the title is nearly ready, as intention would be determined on the date of registration. This could increase certainty but, in doing so, may influence the person’s behaviour if they otherwise would have entered into the agreement on an earlier date.
- 2.25 A further distortion that occurs under the “disposal” interpretation, and where land values are increasing, is that there is an incentive for the taxpayer to defer disposing of the land (the lock-in effect) until title is acquired. However, if land values are decreasing, there is an incentive for the taxpayer

to dispose of the land before title is acquired, and to state that the land was acquired for the purpose of resale in order to claim a tax loss. Under the “first interest” interpretation, such distortions do not arise because the intention is determined at the earlier phases of the sale and purchase agreement.

Impact on property market

- 2.26 In addition, the disposal interpretation could produce arguably an inefficient outcome for the property market. Consider, for example, the development of an apartment complex that will take a number of years to complete. The developer may not proceed with construction unless a number of the apartments have been pre-sold. If purchasers are unwilling to enter into an arrangement until a date closer to completion and registration, because they need certainty about their tax liability, the developer may lack sufficient capital (or means to secure capital) to proceed with the development. There may also be an incentive for the purchaser to require a lower price (operating as a risk margin) to compensate for the uncertainty. However, this situation may not arise in practice because the price and the willingness to enter into a contract are influenced more by non-tax factors.

Other factors to consider under the “first interest” interpretation

Agreements not in writing or registered on the land title

- 2.27 Although most disposals of estates or interest in land are executed through a sale and purchase agreement, not all disposals require a sale and purchase agreement/written form of a contract, or need to be registered on the land title. For example, leases and assignments of a lease do not need to be registered on the title, and in some circumstances may not need to be evidenced in writing. Therefore a date of acquisition test which is based on the phases of a sale and purchase agreement may appear to be limited to only disposal in these agreements.
- 2.28 However, the underlying principle of the first interest interpretation where the date is based on the first interest that arises in an agreement (either the date the agreement is entered into or the date the agreement goes unconditional and the Court can order specific performance of the legal title transfer) is still relevant in these types of disposals. This is because there must be some form of agreement between the parties, irrespective of whether it is or is not evidenced in writing or registered (or not) on the title.

Options to acquire land

- 2.29 The definition of “land” in the Income Tax Act 2007 includes “options to acquire land”. If the Government decides to clarify the legislation to reflect one of the dates under the first interest interpretation, then:
- if the date of acquisition is the date the agreement was entered into, then for an option, this is the date the option was granted; or
 - if the date of acquisition is the date the agreement goes unconditional, in the case of an option this is the day that the option is exercised.

CHAPTER 3

Possible dates of acquisition

Summary of proposals

The date of acquisition would be either:

- Option 1 – the date the agreement for the sale and purchase of “land” is entered into; or
- Option 2 – the date when all the conditions of the agreement for the sale and purchase of “land” have been fulfilled.

3.1 As mentioned in the previous chapter, the first interest interpretation is the preferred interpretation from a policy perspective as it provides greater certainty and is more economically efficient than the disposal interpretation.

3.2 Under the first interest interpretation there are two possible options for the date of acquisition:

Option 1 – the date the agreement is entered into (even if the agreement was still conditional); or

Option 2 – the date when all the conditions of the agreement had been fulfilled (that is, the date the agreement goes unconditional).

Indicative characteristics of each option

3.3 To provide guidance, the following are indicative characteristics (but by no means exhaustive) of when either date may occur.

Option 1 – the date the sale and purchase agreement is entered into

- the date a binding sale and purchase agreement is signed by the vendor or purchaser (including nominees or agents); or
- the “Date” indicated on a binding sale and purchase agreement, which is then subsequently signed by the parties to the agreement; or
- the date a binding oral agreement for the disposal of land was agreed to by the parties, which has then been subsequently actioned by part performance of the agreement and if required later, evidenced by a memorandum; or
- the date the first equitable estate or interest in land is acquired under a binding agreement for the sale and purchase of land and specific performance in the wider sense of all equitable remedies is potentially available to the purchaser (such as injunction or award for damages).

Option 2 – the date the sale and purchase agreement goes unconditional

- the date when all conditions agreed to by the parties, subsequent to the entering into the sale and purchase agreement are all fulfilled; or

- the date an equitable estate or interest in land is acquired under a binding sale and purchase agreement, and specific performance in the strict sense is potentially available to the purchaser (that is, a Court order requiring the agreement to be performed in accordance with the terms of the agreement by ordering the transfer of the land title).

The advantages and disadvantages of either option

3.4 There are numerous advantages and disadvantages that arise for both these options. These are summarised and discussed briefly in the table below.

	Option 1 Date agreement is entered into	Option 2 Date agreement goes unconditional
Decision-making by taxpayer – is there a decision that the taxpayer needs to make at this point of the agreement?	A clear decision is required by the taxpayer to enter into the agreement, even if documentation is signed by an agent or a nominee of the taxpayer.	No clear decision required at this stage. Active steps may be required by the taxpayer to ensure the conditions are fulfilled – for example, instructing solicitors.
Clarity of date (bright line) – is the date at which this point of the agreement is clearly distinguishable or marked?	Clear bright line of the date that agreement is entered into in most circumstances. The line is less clear in circumstances when there has been part-performance before an actual agreement is drawn up or signed. Equitable bright line, as the taxpayer at this point has acquired an equitable interest and the Court could order specific performance in the wide sense – for example, an injunction/caveat or an award for damages.	The date in which conditions are fulfilled is not as clear, as conditions are usually fulfilled by third parties. Equitable bright line as it is at this point that the Court could order specific performance in the strict sense – for example, ordering the transfer of the land title.
Evidence – is there sufficient evidence to support the taxpayer’s intention?	Likely to be minimal evidence to prove the taxpayer’s intention or purpose.	More evidence is available to either prove or disprove the taxpayer’s intention, particularly if third parties are engaged as there is likely to be documentation to support that engagement. For example, there may be a short-term finance agreement which could indicate that the taxpayer is not intending to retain the land.

Decision-making at phases of the sale and purchase agreement

- 3.5 As the policy intent of section CB 6 is to capture property speculators, arguably the most appropriate time to assess a taxpayer's intention and purpose should be when a person decides to enter into a sale and purchase agreement. It is the initial decision-making that informs how a person intends to use the property. It would be unusual for a property speculator to enter into a sale and purchase agreement unless they thought it very likely that the purchase and its subsequent disposal would be profitable.
- 3.6 Generally speaking, there are no clear or additional decisions or actions made by the taxpayer at any other time in the agreement except perhaps the decision to engage third parties to carry out the conditions of the agreement.

Bright line

- 3.7 One of the key advantages of option 1 (the date the agreement was entered into) is that there is more likely than not a clear date or "bright line" of when the agreement was entered into. For example, the date when the sale and purchase agreement was signed (by either or both parties).
- 3.8 For option 2 (the date the agreement goes unconditional), the fulfilment of the conditions in a sale and purchase agreement is usually achieved through other mechanisms and often by third parties (such as obtaining finance from a bank, or a LIM report from the local council). Arguably, at that time, the taxpayer's decision to purchase the property, for whatever reason, has already been made.
- 3.9 Potentially there are also bright lines available at both stages in the form of equitable remedies as noted in chapter 2 – that is, the equitable remedy of specific performance (either in a wide or strict sense).

Evidence

- 3.10 The main disadvantage of having the date of acquisition at the early stages of a sale and purchase agreement is the practical difficulty in providing evidence to prove or disprove a taxpayer's subjective intention.
- 3.11 This is less of an issue under option 1 (the date the agreement goes unconditional) than option 2, as being able to take third party information into account may assist the Commissioner of Inland Revenue in determining what the taxpayer's actual intention for the land is.
- 3.12 A possible legislative solution to address this problem is discussed in the next chapter.

CHAPTER 4

Evidence of intention or purpose

- 4.1 As noted in the previous chapter, one of the main difficulties associated with the date of acquisition being set at the earlier phases of a sale and purchase agreement is the problem of providing evidence of a person's subjective intention or purpose.
- 4.2 Currently, if the taxpayer disputes a Commissioner's assessment of their tax liability or vice versa, the statutory burden of proof requires the taxpayer to prove, on the balance of probabilities, that the Commissioner's assessment is incorrect. In the context of section CB 6, this means that the taxpayer has to prove on a balance of probabilities that they had no intention or purpose to dispose of the land when they acquired the land.
- 4.3 The practical concern is that if the date of acquisition is marked at the earlier phases of an agreement for the sale and purchase of land, both the taxpayer and the Commissioner may have little evidence to prove or disprove the taxpayer's intention at this time.
- 4.4 This evidentiary problem does not impact on providing certainty in relation to determining the date of acquisition, but it does present practical implications, particularly for the Commissioner, who has to determine what the taxpayer is thinking at a specific point in time.
- 4.5 A suggestion to address this practical concern is to legislatively allow the Commissioner and taxpayer to consider and submit evidence that is before and after the date of acquisition, albeit introducing an objective element to this provision. Therefore if a dispute were to progress through to the challenge procedures, the relevant deciding authority in considering what the taxpayer's intention was, will ask "what is the taxpayer's intention or purpose using all the reasonable information available to me?"
- 4.6 It is arguable that this is already the situation, given that the Courts have held that although purpose or intention is to be determined on a subjective basis, it must be determined on the totality of the evidence.⁵
- 4.7 However it is suggested that by providing a legislative provision to this effect, it will clearly reaffirm the common law position and ensure that the Court can consider the totality of the evidence before and after the date of acquisition not just the totality of the evidence at the date of acquisition.
- 4.8 We welcome feedback on this suggestion.

⁵ *Case Y3* (2007) 23 NZTC 13,028, see also *National Distributors Ltd v CIR* [1989] 3 NZLR 661 (CA).

APPENDIX

History of section CB 6

The profits made from the sale or disposition of real property were first deemed to be a source of “business income” in the Land Income Assessment Act 1891. It was introduced at a time when New Zealand had extensive immigration due to a booming export market, and there was high demand for land for settlement. However, since much of the freehold land in New Zealand was tied up in large estates, the Government undertook extensive land reforms to free-up land for genuine settlers.

The high demand and the scarcity of available freehold land created the prime opportunity for property speculators to make a profit from the purchase and disposal of real property, without the property speculator necessarily improving or developing the land. The Government sought to discourage this behaviour by introducing a provision to tax gains from the disposition of land, if the land was acquired for the purpose of disposing of it at a profit.⁶

The initial purpose of this provision was clarified by the Minister of Finance, Hon James B Allen, when the Land and Income Assessment 1908 Act was amended by the Land and Income Assessment Amendment Act 1912:⁷

This is not an alteration in the law, but for the purpose of making the present Act clearer. Persons who speculate in land are liable to assessment for income tax on the profits from buying and selling the land.

Legislative history of section CB 6

Due to its introduction in the late 1800s, the legislative history of what is now section CB 6 is lengthy. Over the years this provision for the taxation of property disposition profits (the “provision”) has been amended by:

- extending the provision to cover both real and personal property,⁸ then dissected into two separate provisions covering real and personal property;⁹ and
- adding a new subsection (now section CB 6(3)) to apply to land “whole or part of any land... or the whole or part of any such land together with other land”.¹⁰

The following paragraphs highlight some of the key changes during the provision’s extensive legislative history.

Removal of the “profit-making purpose” requirement

A key element in the earlier taxation of the property disposition provision was the “profit-making purpose” requirement, that is, a person would be taxed if the property was acquired for the purpose of selling or disposing of it at a profit.¹¹ This profit-

⁶ Land and Income Assessment Act 1912, section 54.

⁷ (29 August 1912) 159 NZPD 624.

⁸ Land and Income Tax Amendment Act 1951, section 10.

⁹ Land and Income Tax Amendment Act 1973, section 8(2). Section 88(1)(c) deal with personal property only and new provisions sections 88(1)(cc) and 88AA dealt with the disposition of land.

¹⁰ See Income Tax Act 2007 section CB 6(3).

¹¹ Land and Income Tax Act 1916, section 85(c).

making purpose element ensured the provision specifically targeted property speculators, rather than capturing “everybody”.

The profit-making purpose requirement was later removed by the Land and Income Tax Act 1954.¹² The explanatory note on the bill indicates that the provision was being extended to apply to all classes of property and it appears the profit-making element was removed during the drafting of this amendment.

The effect of this amendment meant the provision only required a “purpose to dispose” and the provision had widened to capture any person with the necessary purpose, not just property speculators. Therefore although the profit-making element was removed, the provision still intended to tax the gains and profits derived from the sale of land when the taxpayer’s business was dealing in land or the land was acquired for resale.

The insertion of “intention”

As mentioned above, originally the provision only required the person to have a “purpose of disposal”. However the additional subjective element of intention was inserted at the recommendation of the Taxation Review Committee, which was in 1967 assigned the task of carrying a comprehensive review of the New Zealand tax system.

The Taxation Review Committee was of the view that the provision needed to be strengthened:¹³

First, where the question to be decided is whether a taxpayer has acquired property for the purpose of selling or otherwise disposing of it the Courts have held that in law there is a distinction between purpose and intention. This has enabled taxpayers to argue successfully that, although their intention on purchasing property may have been to sell part of it at some later stage, their purpose in acquiring the property was not to sell it but to use it in some way. That being so, profits derived from the sale of part or even all of the property were not assessable for tax. The Committee considers that the distinction between “purpose” and “intention” is artificial and should be removed.

The Minister of Finance, Sir William Rowling, in a Cabinet paper on the relevant bill confirmed that the amendment would reinforce the income tax law relating to income from dealings in real property:¹⁴

It has always been intended that, where a person buys property with the purpose or intention of later selling at a profit, he should be assessable for tax, but Court decisions have negated this objective in some circumstances.

A new whole/part/any subsection

The introduction of “intention” also strengthened a new subsection to cover situations when land that is disposed of constitutes the whole or part of any land (now subsection CB 6(3)).

¹² Land and Income Tax Act 1954, section 88(c).

¹³ Taxation Review Committee *Report of the Taxation Review Committee*, (1967) chapter 44, para. 659.

¹⁴ *Briefing paper to Cabinet HO 744*. This was approved for inclusion in the 1973 amendment bill in a Cabinet decision made 30 July 1973 [CM 73/34/23 refers].

According to an Inland Revenue Head Office Circular, this subsection was recommended as a direct result of the Australian case *Moruben Gardens*,¹⁵ when the Australian High Court held that it was necessary for there to be a clear “identity” between the estate or the interest acquired, and the estate or interest disposed of. The whole/part/any subsection and the test of “purpose and intention” sought to circumvent this decision.

The definition of “land”

A further key change to the taxation of property profits provision in the 1973 Act was the inclusion of a definition of “land”. The new definition of land included any estate or interest in land (whether legal or equitable, corporeal or incorporeal) and any option to acquire land or any such estate or interest in land (but not including a mortgage). Previous provisions only referred to “real property”, “property”, “land or any interest therein”, “real or personal property or any interest therein”.

This amendment has been considered by the New Zealand Institute of Chartered Accountants as an effective widening of the ambit of the provision:¹⁶

This new definition of “land” had a number of effects:

- It clarified the statutory meaning of the term “land” (i.e. including any estate, whether legal or equitable, corporeal or incorporeal) applied to the land speculation provision.
- It was drafted using words (i.e. “any estate or interest in land”) that linked it up with the definition of “estate” or “interest” in land contained in section 2. This clarified the application of the broader definition of “interest in land” to the land speculation provision.
- Accordingly any option to acquire land or an interest in land was within the purview of the new section 88AA.

However despite the new definition in the 1973 Act, the definition of “land” that would have applied in the absence of any specific income tax at definition is likely to have derived from the definition of land in the Interpretation Act 1888:

“land” includes messuages, tenements, hereditaments, houses, and buildings, unless there are words to exclude houses and buildings, or to restrict the meaning to tenements of some particular tenure:

From a historical perspective, it appears that Parliament had contemplated that any interest, estate or right in real property disposed of in a business context should be subject to tax.

Currently “land” for the purposes of section CB 6(1) includes any estate or interest in land, including those estates and interests specifically mentioned in section YA 1. The definition of land in the Income Tax Act 2007 uses the legal concept of land (that is, a bundle of tangible and intangible rights a person holds in land) as opposed to the ordinary usage of the word “land”, the “dirt” or geographical area of soil.

This definition reflects the doctrine of tenure, in that all land (in the geographical soil/dirt sense) in New Zealand is owned by the Crown, and an individual can only own interests or estates in the land.

¹⁵ *Moruben Gardens Pty Ltd v Commissioner of Taxation (Cth)* (1972) 46 ALJR 559; 3 ATR 225; 72 ATC 4147 (HC).

¹⁶ Letter from Aylton Jamieson (NZICA) to Inland Revenue *Brochure on property purchased “off the plans”*, 5 March 2010.

The Property Speculation Tax Act 1973

Another piece of legislation targeted at the profits from property disposal was the Property Speculation Tax Act (the PST Act). The PST Act was introduced in 1973 and was designed to deter property speculation at a time when the country was suffering from high inflation and a shortage of housing.

Although the taxation of property disposition provisions in the 1954 Act and the PST Act overlapped, the 1954 Act provision had wider implications and covered more than just property speculators.

The PST Act did however provide a definition of the date of acquisition:

“Date of acquisition” in relation to the acquisition of land by any person and subject to sections 11 and 12 of this Act, means the date on which possession of the land is given and taken in respect of that acquisition or, in any case where possession is not taken by that person or where no right to possession exists, the date on which the land becomes vested in that person.

The PST Act however was short lived and repealed in 1979 by the Government on the grounds that it was irrelevant and not needed due to the taxation of property disposition provisions in the Land and Income Tax Act.

The relationship between the Income Tax Act and “other” law

In light of the core provisions contained in Part A of the Income Tax Act 2007, if the legislation wants to treat a transaction differently from “other” law (such as land law or contract law) it does so clearly. For example, contract and insurance law underpins life insurance contracts, however the Income Tax Act 2007 has specific life insurance rules to deal with income derived from these transactions.

In the context of section CB 6, the laws of equity, land and contract underpin the taxation of these transactions.

The interaction between equity, land and contract law in land transactions

For a contract for the disposition of land to be enforceable, its terms and conditions must be set out in writing and be signed by the parties.¹⁷ The normal commercial practice is for the parties to the contract to execute a standard form of an agreement for sale and purchase.

Where an agreement is subject to “true conditions precedent”, a binding agreement will not be formed until the conditions are satisfied.¹⁸ An agreement that contains a condition subsequent is a binding contract.¹⁹ For example, the commonly used Real Estate Institute and Auckland District Law Society standard form of agreement provides that conditions in the agreement are conditions subsequent, unless the agreement “expressly provides otherwise”.

A consequence for the parties entering into a binding contract for the sale and purchase of land is that the rules of equity provide for an equitable interest to arise in favour of the purchaser. If the rules of equity and the law of contract are in conflict,

¹⁷ Property Law Act 2007, section 24.

¹⁸ *Scott v Rania* [1966] NZLR 527.

¹⁹ *Waitata Holdings Ltd v Mansfield* (High Court, Nelson; M3/00; 9 August 2000).

section 99 of the Judicature Act 1908 provides for the rule of equity to prevail provided the matter applies to substantive law.²⁰ The Court has held that an equitable interest is “not carved out of a legal estate, but impressed upon it”.²¹

The key question in determining whether an equitable interest has arisen in favour of the purchaser is “will equity protect the rights of the purchaser’s interest under the agreement?” The equitable remedies available are the ability to compel a transfer (specific performance) or grant, or to restrain a party from dealing with the land in a manner which is inconsistent with the contract.²² Therefore in brief, the purchaser obtains a right to enforce the contract:²³

Now, the foundation of the doctrine of specific performance was this, that land has quite a character of its own, that the real meaning between the parties to a contract for sale of land was not that there should be a contract with legal remedies only, and that the purchaser should get the land, and should not be put off in an ordinary case by offering him damages. That is the main part of the doctrine of specific performance – that the purchaser is actually to get the land.

In *Re Transphere*, McLelland J held that the absolute ownership of the property cannot be precisely divided into a legal estate and an equitable estate.²⁴ The equitable interest impressed on the legal estate is conditional on completion of the contract.

During the period between the contract being formed and settlement being completed, the vendor holds the legal estate under a constructive trust for the purchaser. On settlement of the purchaser’s obligations, it appears that it is at this time that the rights attaching to the equitable interest then relate back to the point in time when the purchaser is able to obtain specific performance.

A purchaser is able to divest the right to enforce the contract in any of the following ways:

- by the purchaser expressly declaring himself or herself to be trustee of the equitable interest for a beneficiary;²⁵
- by an express assignment by the purchaser to another, either in equity or under a statutory provision;²⁶
- by a purchaser’s direction to his or her trustee requiring the trustee to hold the property on trust for another;²⁷
- by a purchaser releasing, surrendering, or disclaiming his or her interest;²⁸ or

²⁰ *Mayor of Dunedin v Searl* (1915) 34 NZLR 861.

²¹ *DKLR Holding Co (No 2) Pty Ltd v Commissioner of Stamp Duties* (NSW) (1982) 149 CLR 43 at 474; 40 ALR 1 at 35 per Brennan J. This decision was approved by Randerson J in *Smith v Hugh Watt Society Inc* [2004] 1 NZLR 537.

²² G W Hinde, D W McMorland, N R Campbell, and D P Grinlinton *Land Law in New Zealand* (Wellington, LexisNexis, 2003) paragraph 4.019; *Bevin v Smith* [1994] 3 NZLR 648, (1994) (CA), *McDonald v Isaac Construction Co Ltd* [1995] 3 NZLR 612 at 619 per Tipping J, *Re Transphere Pty Ltd* (1986) 5 NSWLR 309 at 311.

²³ *Re Scott and Alvarez’ Contract* [1895] 2 Ch 603 (CA) at 612 and 615. This decision was cited as good authority in *Loan Investment Corporation of Australasia v Bonner* [1970] NZLR 724 (PC) in the majority judgement delivered by Lord Pearson.

²⁴ *Re Transphere Pty Ltd* (1986) 5 NSWLR 309.

²⁵ *Comptroller of Stamps (Vic) v Howard-Smith* (1936) 54 CLR 614; [1937] VLR 15; [1936] ALR 198.

²⁶ *Norman v Federal Commissioner of Taxation* (1963) 109 CLR 9, per Windeyer J.13, sections 25 and 49 of the Property Law Act 2007.

²⁷ Rickett C., *The Laws of New Zealand: Equity* LexisNexis, paragraph 23.

- by expiration of a person's equitable interest under a trust because of the exercise of a power of revocation of the trust, or by termination of the trust by choice of the beneficiaries.²⁹

The right to enforce the contract is normally merged with the conveyance unless the parties provide that the rights and obligations under the agreement for sale and purchase survive the doctrine of merger.³⁰ The completion of a land sale occurs on the registration of the transfer instrument (an act conferred by the state, not the parties to the contract), and it is at this point in time where the legal estate vests in the purchaser.³¹

²⁸ Ibid.

²⁹ Ibid.

³⁰ *Knight Sugar Co Ltd v The Alberta Railway & Irrigation Co* [1938] 1 All ER 266 (PC) at 269 per Lord Russell of Killowan, *Svanosio v McNamara* (1956) 96 CLR 186; [1956] ALR 961; 30 ALJ 372, *Griffiths v Ellis* [1958] NZLR 840, and *Stanford v Bayne* [1923] VLR, see also *DKLR Holdings Co (no 2) Pty Ltd v Commissioner of Stamp Duties* (NSW) 82 ATC 4125.

³¹ *Montgomery and Rennie v Continental Bags (NZ) Ltd* [1972] NZLR 884.