

EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY

Deadline for comment: 7 April 2016. Please quote reference: PUB00260.

QUESTION WE'VE BEEN ASKED QB XX/XX

INCOME TAX – LAND ACQUIRED FOR A PURPOSE OR WITH AN INTENTION OF DISPOSAL

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Question We've Been Asked is about s CB 6.

Question

1. If I buy land for a purpose or with an intention of selling it, do the proceeds of the sale need to be included as income for tax purposes?

Answer

2. Yes. If you buy land for a purpose or with an intention of selling it, the proceeds of the eventual sale, whenever that occurs, will be income under s CB 6 unless one of the exclusions from that rule (for residential land and business premises) applies.

Explanation

What is the relevant taxing provision?

3. Section CB 6(1) provides that:

CB 6 Disposal: land acquired for purpose or with intention of disposal

Income

- (1) An amount that a person derives from disposing of land is income of the person if they acquired the land—
 - (a) for 1 or more purposes that included the purpose of disposing of it;
 - (b) with 1 or more intentions that included the intention of disposing of it.
4. An amount that you derive on the disposal of land will therefore be income under s CB 6 if you acquired the land for a purpose or with an intention of disposing of it. Disposal does not have to be your dominant purpose.
5. There are two exclusions from this. Even if you acquired the land for a purpose or with an intention of disposing of it, you **will not be taxed** on the proceeds of the sale if one of these exclusions applies:

Exclusion 1 – Residential land (s CB 16)

If the land has a house on it, or you build one, and you occupy the house mainly as a residence, you will not be taxed on the proceeds from selling the property. This also applies if you are trustee of a trust, and a beneficiary of the trust occupies the house mainly as a residence.

Please note that you cannot use this exclusion if you have a regular pattern of acquiring and disposing of houses, or building and disposing of houses.

Exclusion 2 – Business premises (s CB 19)

If the land is the premises of a business, and you acquired and occupied the premises or built and occupied the premises mainly to carry on a substantial business from them, you will not be taxed on the proceeds from selling the property.

EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY

Please note that you cannot use this exclusion if you have a regular pattern of acquiring and disposing of, or building and disposing of, premises for businesses.

How does the purpose or intention rule relate to the 2-year "bright-line" rule?

6. The new 2-year "bright-line" rule (s CB 6A) taxes any gains from residential property that is disposed of within two years of being acquired. There are special **rules about when you are treated as acquiring the land for the "bright-line" rule**. In a typical land purchase situation, this will be when the title is registered to you. There are some exclusions from the 2-year "bright-line" rule, including an exclusion for your main home.
7. The 2-year "bright-line" rule is **in addition** to the other land sale rules that have **been in New Zealand's tax law for many years**. The 2-year rule is aimed at being easy to enforce, by removing the need to determine what a **person's purpose or intention** was if they sell residential land within two years of acquiring it. But if the 2-year rule does not apply, the proceeds from selling land can still be taxed under one of the other land sale rules, including the purpose or intention rule.

When will the proceeds of a land sale be income under s CB 6?

8. As noted above, an amount that you derive on the disposal of land will be income under s CB 6 if you acquired the land for a purpose or with an intention of disposing of it. But remember that there are exclusions for residential land and business premises that might apply (see [5]).
9. The key things to bear in mind in deciding if s CB 6 applies are:
 - What matters is your purpose or intention **when you acquired** the land.
 - A purpose or intention of disposing of the land does not need to be the only purpose or intention you had when you acquired the land. It also does not need to be your dominant or main purpose or intention. It is enough if disposal is one of your purposes or intentions.
 - Disposing of the land has to be more than a vague idea or just a possibility or option in the future. You have to have a firm purpose or intention of disposing of the land.
 - The test of whether you had a purpose or intention of disposing of the land is subjective. But what you say your purpose or intention was will be assessed against all of the circumstances.
 - Evidence of what your purpose or intention was before you acquired the land (eg, during the whole acquisition process) can be taken into account.
 - The extent of commitments you make or steps you take shortly after you acquired the land may be relevant in testing what your subjective purpose or intention was.
 - The length of time you held the land may also be taken into account, and if you have a pattern of acquiring and disposing of land within relatively short timeframes, that is likely to be relevant.
 - The onus is on you to show that you did not acquire the land for a purpose or with an intention of disposing of it.

(See for example: *CIR v Boanas* (2008) 23 NZTC 22,046 (HC), *Case N59* (1991) 13 NZTC 3,457, *Harkness v CIR* (1975) 2 NZTC 61,017 (SC), *Anzamco Ltd (in liq) v CIR* (1983) 6 NZTC 61,522 (HC), *Case Y3* (2007) 23 NZTC 13,028 and *Jurgens & Doyle v CIR* (1990) 12 NZTC 7,074 (HC)).

EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY

When do you test what my intention was?

10. As noted above, it is your purpose or intention when you **acquired** the land that is relevant.
11. Land is normally acquired for s CB 6 purposes on the date you enter into a binding sale and purchase agreement to buy the land (even if this is subject to conditions, eg, finance, or obtaining a satisfactory LIM or building report). The time of acquisition may be different in particular circumstances, for example, if you acquired the land through exercising an option (see s CB 15B).¹

What if I did not have any firm intention when I bought the land?

12. If at the time you acquired the land you did not have a firm purpose or intention of disposing of it, you will not be taxed on the proceeds of its eventual sale under s CB 6.
13. However, if the Commissioner questions whether you acquired the land with a purpose or intention of disposal, remember that the onus is on you to show that you did not. What you say your purpose or intention was will be assessed against all of the circumstances.

What if my intention changes and I decide not to sell the land?

14. The only thing that is relevant is your purpose or intention when you **acquired** the land. If you acquired the land with a purpose or intention of disposing of it, but change your mind and decide to do something else (eg, rent the property out), you will still be taxed on the proceeds if you eventually sell it.

What if I own the land for more than 10 years before I sell it?

15. A common misconception is that if you hold the land for more than 10 years you will not be taxed on the sale proceeds. This is not true. If you acquired the land with a purpose or intention of disposal, s CB 6 will apply to tax the proceeds **whenever** you eventually sell the land (subject to the exclusions noted at [5]).

What if I have rented out the property and paid tax on the rental income?

16. As noted above, if you acquired the land with a purpose or intention of disposing of it, but change your mind and decide to rent the property out instead, you will still be taxed on the proceeds when you eventually sell it. This is the case even though the rental income will have been subject to tax. The rental income and the proceeds on the sale are both taxed under the Act (see s CC 1).

What if I only sell some of the land?

17. It does not matter if you divide the land and sell only some of it at any one time – you will still be taxed on the proceeds of all of the land whenever it is sold. Similarly, it does not matter if you sell the land you acquired together with some other land. The proceeds on the sale of the original piece of land you acquired with a purpose or intention of disposal will be taxed under s CB 6 irrespective of what you subsequently do with the land or its boundaries (see ss CB 6(3) and CB 23B).

What if a trust or company buys the property?

18. Section CB 6 can apply regardless of whether the property is acquired by an individual person or an entity such as a trust or company. If the owner is a trust or company, it is generally the purposes or intentions of the trustees or directors that are relevant in deciding if s CB 6 applies.

¹ Note that these rules about when land is acquired apply for disposals of land on or after 22 November 2013.

EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY

Does this only apply to sales of freehold land?

19. No. "Land" is defined in the Act as including any estate or interest in land, and as including an option to acquire land or an estate or interest in land. You could be taxed under s CB 6 if you dispose of any land interest, not just the freehold estate. For example, you could be taxed if you dispose of a leasehold, unit title or cross-lease interest, an option to acquire land, or an equitable interest in land (eg, by transferring the right to acquire land under a sale and purchase agreement to someone else).

Can I gift the land instead so I do not have to pay tax?

20. No. Property cannot be gifted to get around paying tax on its sale. The Act would treat a gift of land you acquired with a purpose or intention of disposal as being made at market value. You would be subject to tax on that amount, less any allowable deductions (see ss FC 1 and FC 2).

Can I get any tax deductions?

21. Yes. If s CB 6 taxes you on the proceeds of selling land, you will get a deduction for the cost of the land and any capital improvements you make to it, to the extent that those costs are incurred in deriving the income and are not private in nature (ss DB 23, DA 1 and DA 2(2)). The deduction is taken in the income year in which you dispose of the land (see s EA 2).
22. You may also be able to deduct other expenditure, such as interest on money borrowed to purchase the land, insurance, and repairs and maintenance that are not capital in nature. Deductions for these expenses will be allowed to the extent that they are incurred in deriving the income and are not private in nature (ss DA 1, DA 2 and DB 6).

Other taxing provisions that could apply if s CB 6 doesn't

23. Even if the 2-year "bright-line" rule (see from [6]) and s CB 6 (see from [8]) do not apply to you, there are a number of other land sale rules in the Act that might tax you on the sale proceeds. For example, you might be taxed on the proceeds of selling land if:
- you acquired the land for the purpose of a business (carried on by you or by an associated person) of dealing in land, developing land, dividing land into lots, or erecting buildings (s CB 7);
 - you dispose of the land within 10 years of acquiring it, if at the time you acquired it you were (or were associated with someone who was) in the business of dealing in land, or developing or dividing land (ss CB 9 and CB 10);
 - you dispose of the land within 10 years of completing improvements to it, if at the time you acquired it you were (or were associated with someone who was) in the business of erecting buildings (s CB 11); or
 - the land was part of an undertaking or scheme, meeting certain criteria, that involved the development of land or the division of land into lots (ss CB 12 and CB 13).
24. There are exclusions from each of these rules that might be relevant to you.

What if I have possibly taken an incorrect tax position for past property sales?

25. If you think you may have taken a tax position for property sales in past tax years that is different from the Commissioner's position on how these provisions apply, we suggest you discuss the matter with your tax advisor, or us, and consider making a voluntary disclosure.

Examples

26. The following examples are included to assist in explaining the application of the law. The examples do not consider the criteria for the exclusions to s CB 6 in any great detail, as they clearly do not apply in any of the circumstances considered. The examples do not consider whether any of the other land sale rules in the Act apply.

Example 1 – Change of purpose or intention between contract and settlement

27. On 10 September 2015, Tabitha and Jono entered into a sale and purchase agreement to buy a house for \$2m. They planned to move into the house with their three children. On 21 September 2015, before settlement of the purchase, Tabitha and Jono were approached with an unsolicited offer to purchase the property for \$2.25m. Tabitha and Jono decided that this offer was too attractive to turn down, confident they could find another equally desirable family home for that amount. Tabitha and Jono therefore accepted the offer on 23 September 2015, entering into a sale and purchase agreement to sell the house. **Tabitha and Jono's purchase of the property was settled on 25 September 2015, and their sale of the property was settled the following week.**
28. The 2-year "bright-line" rule does not apply to Tabitha and Jono's sale of the property, because they acquired it before 1 October 2015.² If Tabitha and Jono had acquired the property on or after 1 October 2015, the proceeds of the sale would be taxed under the 2-year "bright-line", and it would not be necessary to consider s CB 6.
29. For the purposes of s CB 6, Tabitha and Jono acquired the land on 10 September 2015, when they entered into the sale and purchase agreement to buy the property. At that time, their intention was for the house to be their family home. It does not matter that by 25 September 2015, when their purchase of the property was settled, they intended to dispose of it, and indeed had already entered into a sale and purchase agreement to do so. It was only because of an attractive, unsolicited offer that Tabitha and Jono changed their minds about living in the property and decided to dispose of it instead. At the date they acquired the property (10 September 2015), they did not intend to dispose of it.
30. The proceeds on the sale are therefore not income to Tabitha and Jono under s CB 6.

Example 2 – Change of purpose or intention after acquisition, and property held for over 10 years

31. On 11 October 2005, Laura and Connor entered into a sale and purchase agreement to purchase a property that they intended to renovate and on-sell. They advised their bank of this, as they needed to borrow sufficient funds to pay for the renovations. The purchase of the property was settled on 30 October 2005, and Laura and Connor started the renovations. After the renovation work was complete, Laura and Connor decided not to sell the property at that time, but to rent it out instead. Laura and Connor have paid tax on the rental income. In 2015, Laura and Connor decided to sell the property, and they did so on 4 December 2015.
32. The 2-year "bright-line" rule does not apply to Laura and Connor's sale of the property, because they acquired it before 1 October 2015. Even if the property

² In a typical land purchase situation, the date of acquisition for the "bright-line" rule will be when the title is registered to the purchaser. But in this case, because Tabitha and Jono sold the property before the legal title was transferred to them, for the purposes of the "bright-line" rule they are treated as acquiring the property on 10 September 2015, when they entered into the sale and purchase agreement to buy the property. (See s CB 6A).

EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY

had been acquired on or after 1 October 2015, the 2-year "bright-line" rule would not apply because the property was not sold within two years of being acquired. Therefore, in those circumstances it would still be necessary to consider s CB 6.

33. For the purposes of s CB 6, Laura and Connor acquired the land on 11 October 2005, when they entered into the sale and purchase agreement to buy the property. At that time, their intention was to renovate the house and sell it. It does not matter that Laura and Connor subsequently changed their minds and decided to rent the property out instead of selling it. At the date they acquired the property, their purpose or intention was to dispose of it.
34. Neither the residential exclusion (s CB 16) nor the business exclusion (s CB 19) apply, because Laura and Connor did not live in the property or carry on a business from it.
35. The proceeds on the sale of the property are therefore income to Laura and Connor under s CB 6.
36. It is not relevant that the rental income was subject to tax – the Act taxes rental income as well as the proceeds on the sale of the property.
37. It is not relevant that Laura and Connor held the property for more than 10 years before selling it. If land is acquired with a purpose or intention of disposal, the proceeds will be taxed whenever the property is eventually sold.
38. Laura and Connor can get a deduction against the sale proceeds for the amount they paid to acquire the property and for the cost of any renovations that were capital in nature. In each year they owned the property, they will also have been allowed to deduct the interest on the money they borrowed to purchase the property and undertake the renovations, the cost of insurance on the property, and the cost of any repairs and maintenance on the property that were not capital in nature.

Example 3 – Purpose or intention to be assessed against all of the circumstances

39. Taj acquired 28 properties over a 10-year period – all before 1 October 2015. Twenty-three of those properties have been sold to date. Taj considers that none of those sales give rise to income under s CB 6, stating that all of the properties were acquired for long-term rental. Taj states that the twenty-three properties in question were only sold due to financial pressure, the cost of servicing the mortgages, difficult tenants, or because of unsolicited offers to purchase the properties. Taj states that any renovation work done on the properties was for the purpose of deriving higher rental income.
40. However, all of the twenty-three properties were on-sold within relatively short periods after their acquisition, most of them after some renovation work. The average time the properties were held is approximately one year. Ten of the properties were held for less than six months. After each of the twenty-three properties was sold, a new property was purchased within an average of six months. Taj has only returned rental income from two of the properties.
41. The 2-year "bright-line" rule does not apply to the sales of the properties in question, because they were all acquired before 1 October 2015. If Taj had acquired any of the properties on or after 1 October 2015, the proceeds of the sales of those properties would be taxed under the 2-year "bright-line" if the sale was within two years of the property being acquired. It would not be necessary to consider s CB 6 for any sales taxed under the 2-year "bright-line" rule.

EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY

42. The test of whether a taxpayer had a purpose or intention of disposing of land **when they acquired it is subjective. However, a person's stated purpose or intention** needs to be assessed against all of the circumstances.
43. In this case, Taj's explanations for the sales are not supported by the circumstances as a whole. None of the properties were held for long-term rental purposes, which is what Taj says they were acquired for. Indeed, rental income was only returned from two of the properties. The explanations for the sales are not supported by the evidence. The fact that new properties were purchased within an average of six months after each sale undermines **Taj's** assertion that the sales were due to financial pressure and the cost of servicing the mortgages. The pattern of purchases, renovation (in most cases) and relatively fast re-sale of the properties without them having been rented out (for the most part) indicates that Taj acquired the properties with a purpose or intention of disposing of them.
44. Neither the residential exclusion (s CB 16) nor the business exclusion (s CB 19) apply in respect of any of the properties, because Taj did not live in any of them or carry on a business from any of them.
45. Therefore, the Commissioner considers that the proceeds on the sales of the twenty-three properties in question are income to Taj under s CB 6.
46. Taj can get a deduction against the sale proceeds for the amounts he paid to acquire the properties and for the cost of any renovations that were capital in nature. Taj will also be allowed to deduct the interest on the money he borrowed to purchase the properties and undertake the renovations, the cost of insurance on the properties, and the cost of any repairs and maintenance on the properties that were not capital in nature.

Example 4 – Onus on the taxpayer to show that land not acquired with a purpose or intention of disposal

47. Hugh and Meg purchased five residential properties in 2014. They renovated the properties, and sold them in 2015 for a total profit of \$2.2m. Hugh and Meg have stated that they have relatives overseas who had applied for New Zealand residency and who intended to live in the properties. Hugh and Meg assert that the properties were only sold in 2015 because the residency applications were unsuccessful. Hugh and Meg have not provided any evidence that any relatives overseas had applied for New Zealand residency and had those applications rejected.
48. The **2-year "bright-line" rule does not apply to the sales of the properties in question**, because they were all acquired before 1 October 2015. If Hugh and Meg had acquired any of the properties on or after 1 October 2015, the proceeds of the sales of those properties would be taxed under the **2-year "bright-line" if the sale was within two years of the property being acquired**. It would not be necessary to consider s CB 6 for any sales taxed under the **2-year "bright-line" rule**.
49. If the Commissioner questions whether you acquired the land with a purpose or intention of disposal, the onus is on you to show that you did not.
50. Hugh and Meg purchased five properties that they renovated and sold for a profit in a short space of time. They have not provided any evidence that any relatives overseas had applied for New Zealand residency and had those applications rejected. In these circumstances, the Commissioner is not satisfied that Hugh and Meg did not acquire the properties with a purpose or intention of disposal. There is no evidence to support their stated purpose of acquiring the properties as future homes for relatives seeking residency.

EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY

51. Neither the residential exclusion (s CB 16) nor the business exclusion (s CB 19) apply in respect of any of the properties, because Hugh and Meg did not live in any of them or carry on a business from any of them.
52. The Commissioner therefore considers that the proceeds on the sales of the properties are income to Hugh and Meg under s CB 6.
53. Hugh and Meg can get a deduction against the sale proceeds for the amounts they paid to acquire the properties and for the cost of any renovations that were capital in nature. They will also be allowed to deduct the interest on the money they borrowed to purchase the properties and undertake the renovations, the cost of insurance on the properties, and the cost of any repairs and maintenance on the properties that were not capital in nature.

Example 5 – More than one purpose or intention

54. Chris purchased a property in August 2012. The property was marketed as being an attractive investment – ideal as a rental property, and expected to have **“great annual capital growth”**. Chris decided to buy the property to rent it out for three to five years, by which stage he hoped to be able to realise a capital gain on the property. Chris has paid tax on the rental income. He sold the property in October 2015 for a sizeable profit.
55. The 2-year **“bright-line” rule does not apply to the sale of the property, because it** was acquired before 1 October 2015. Even if the property had been acquired on or after 1 October 2015, the 2-year **“bright-line” rule would not apply because the** property was not sold within two years of being acquired. Therefore, in those circumstances it would still be necessary to consider s CB 6.
56. An amount that a person derives on the disposal of land will be income under s CB 6 if they acquired the land for a purpose or with an intention of disposing of it. A purpose or intention of disposing of the land does not need to be the **only** purpose or intention the person had when they acquired the land. It also does not need to be their dominant or main purpose or intention. It is enough if disposal is one of their purposes or intentions.
57. Chris was attracted to invest in the property in question because it was expected to have great annual capital growth, and could be rented out in the meantime. He purchased the property with the purpose of renting it out in the short-medium term and then selling it to realise the expected capital gain.
58. It does not matter that Chris acquired the property for more than one purpose, and disposal was only one of those purposes. When he acquired the property, Chris had a firm purpose of disposing of it in three to five years to hopefully make a capital gain.
59. Neither the residential exclusion (s CB 16) nor the business exclusion (s CB 19) apply in respect of the property, because Chris did not live in it or carry on a business from it.
60. The proceeds on the sale of the property are therefore income to Chris under s CB 6.
61. It is not relevant that the rental income was subject to tax – the Act taxes rental income as well as the proceeds on the sale of the property.
62. Chris can get a deduction against the sale proceeds for the amount he paid to acquire the property and for any capital improvements he made to the property. In each year he owned the property he will also have been allowed to deduct the interest on the money he borrowed to purchase the property, the cost of

EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY

insurance on the property, and the cost of any repairs and maintenance on the property that were not capital in nature.

Draft items produced by the Office of the Chief Tax Counsel represent the preliminary, though considered, views of the Commissioner of Inland Revenue.

In draft form these items may not be relied on by taxation officers, taxpayers, and practitioners. Only finalised items represent authoritative statements by Inland Revenue of its stance on the particular issues covered.

References

Subject references

Income tax, sale of land, purpose or intention of disposal

Legislative references

Income Tax Act 2007 – ss CB 6A, CB 6, CB 7, CB 9, CB 10, CB 11, CB 12, CB 13, CB 15B, CB 16, CB 19, CB 23B, CC 1, DA 1, DB 6, DB 7, DB 23, EA 2, FC 1 and FC 2

Case references

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

Case N59 (1991) 13 NZTC 3,457

Case Y3 (2007) 23 NZTC 13,028

CIR v Boanas (2008) 23 NZTC 22,046 (HC)

Harkness v CIR (1975) 2 NZTC 61,017 (SC)

Jurgens & Doyle v CIR (1990) 12 NZTC 7,074 (HC)