ⓘ This is a reissue of an expired ruling BR Pub 04/06 *Trading stock – tax treatment of sales and agreements to sell.* For more information about the history of this ruling see the background in the commentary.

INCOME TAX — TIMING OF DISPOSAL AND DERIVATION OF INCOME FROM TRADING STOCK

PUBLIC RULING - BR Pub 14/08

This is a public ruling made under s 91D of the Tax Administration Act 1994.

Taxation Laws

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

This Ruling applies in respect of ss CB 1, CB 2, EB 2, and YA 1 (definition of "trading stock").

The Arrangement to which this Ruling applies

The Arrangement is a sale or disposal of property (including a contract of sale of, and an agreement to sell, property) that is part of the trading stock of a business owned or carried on by the vendor. This includes the disposal of trading stock together with other assets of a business.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- When a person sells trading stock in the ordinary course of business, s CB 1 applies to include amounts that are "derived" from the sale within the income of the person. Amounts are derived when the income is earned, being when a legally enforceable debt arises, or the right to be paid otherwise crystallises.

- If trading stock is sold outside the ordinary course of business, or to put an end to the business or part of it, s CB 2 applies to include all amounts received from the "disposal of" the trading stock within the income of the person. The date of disposal differs, depending on whether a clearly expressed intention of the parties exists as to when property in the trading stock is to pass:

    - The date of disposal will be the date the parties intended property in the goods to pass if a clearly expressed intention as to the time of passing of property is evident from the terms of the contract, the conduct of the parties and the circumstances of the case. Circumstances of the case that may be relevant include whether the contract includes a reservation of title or Romalpa clause.

    - If no clearly expressed intention as to the time of passing of property can be determined, the date of disposal will be decided according to the appropriate statutory rule in s 20 of the Sale of Goods Act 1908 as follows:

    - If there is an unconditional contract for goods that are specific and in a deliverable state—the date the contract becomes unconditional.
    - If the vendor must do something to make such goods deliverable—the date such action is completed, and the buyer is notified.
    - If the vendor must weigh, measure, or test such goods to ascertain the selling price—the date such action is completed and the buyer is notified.
    - If goods are delivered to a buyer on "sale or return" or similar terms—the time at which the buyer signifies their approval or retains the goods without notifying rejection within an agreed or reasonable timeframe.
    - If unascertained or future goods are sold by description—when the goods are in a deliverable state and unconditionally appropriated to the contract by either party with the assent of the other.

- Where s CB 2 applies to a disposal of trading stock, s CB 2(3) provides that the purchaser is treated as acquiring the trading stock for the amount that is treated as income of the vendor.

The period for which this Ruling applies

This Ruling will apply for an indefinite period beginning on the first day of the 2014/15 income year.

This Ruling is signed by me on 30 September 2014.

Susan Price
Director, Public Rulings

COMMENTARY ON PUBLIC RULING BR PUB 14/08

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 14/08 (the ruling).

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

Contents

Summary

1. This commentary considers the key issues:

   - Whether s CB 1 or s CB 2 applies when trading stock is sold.
   - When receipts from the sale of trading stock are "derived".
   - When trading stock is "disposed of".

2. Whether s CB 1 or s CB 2 applies depends on whether the trading stock has been sold in the ordinary course of business. Sections CB 1 and CB 2 operate in tandem to ensure all disposals of trading stock give rise to income for tax purposes. However, the timing of when the income arises differs depending on which section applies. Where the trading stock has been disposed of in the ordinary course of business, s CB 1 will apply. This means income arises when it has been derived. Section CB 2 will apply where the trading stock is disposed of outside the ordinary course of business or to put an end to the business or part of it. If s CB 2 applies, income arises at the time the trading stock is disposed of.

3. Income from the sale of trading stock in the ordinary course of business is derived when the income is earned, being when a legally enforceable debt arises or the right to be paid otherwise crystallises.

4. Where s CB 2 applies, trading stock is disposed of when property in the trading stock passes. When property passes depends on whether the parties have clearly expressed their intention as to when property is to pass between them. If they have, property passes and trading stock is disposed of at the date the parties intended. Otherwise, trading stock is disposed of on the date determined according to the appropriate statutory rules in ss 20 or 21 of the Sale of Goods Act 1908 (SGA).

5. The ruling and commentary do not consider the effects of the financial arrangements rules in Part EW of the Act.

Background

6. This ruling is a reissue of BR Pub 04/06 that applied until the end of the 2008 income year and was published in *Tax Information Bulletin* Vol 16, No 5 (June 2004): 17. BR Pub 04/06 was a reissue of an earlier ruling BR Pub 98/8 *Trading stock – tax treatment of disposals* published in *Tax Information Bulletin* Vol 11, No 1 (January 1999): 3.

7. The previous ruling, BR Pub 04/06, set out when ss CD 3 and FB 3 of the Income Tax Act 1994 applied because these sections appeared to overlap in their application. This ambiguity was clarified in the Income Tax Act 2007.

8. The previous ruling also included analysis of when an amount from the sale or disposal of trading stock was "derived" under s CD 3 and when trading stock was "sold or disposed of" under s FB 3. The previous ruling included this analysis because there had been some confusion about when income arises where a business disposes of trading stock.

9. Sections CB 1 and CB 2 are the provisions in the Income Tax Act 2007 that correspond to the former ss CD 3 and FB 3 of the Income Tax Act 1994. The 2007 Act did not alter the timing of when income is derived from trading stock. There has been a minor change in s CB 2, which now refers to trading stock "disposed of" rather than "sold or disposed of". The Commissioner considers that this change does not alter the timing of when trading stock is disposed of.

The issues

10. The key issues are:

- Whether s CB 1 or s CB 2 applies.
- When receipts from the sale of trading stock are "derived".
- When trading stock is "disposed of".

Whether s CB 1 or s CB 2 applies

11. As stated, the Income Tax Act 2007 has clarified whether s CB 1 or s CB 2 applies where there has been a disposal of trading stock. Section CB 1 includes within a person's income an amount they derive from a business. If sales of trading stock occur in the ordinary course of business, s CB 1 will apply to include such amounts within income.

12. However, s CB 2(5) provides that s CB 2 overrides s CB 1. So, s CB 2 will apply instead of s CB 1 to sales of trading stock outside the ordinary course of business or sales that put an end to the business or part of it. Generally, s CB 2 applies to larger transactions involving other assets and/or multiple items of trading stock where the sale is more akin to the sale or disposal of a group of business assets.

13. It is important to establish which section applies to determine the timing of income from sales of trading stock. This is because s CB 1 includes in income receipts from the sale of trading stock when they are "derived". In contrast, s CB 2 includes in income such receipts when the trading stock is "disposed of". These two points in time can be different. In practice, the difference is most likely to matter when a transaction straddles a balance date.

Section CB 1 – when receipts from the sale of trading stock are "derived"

14. Amounts received from the sale of trading stock sold in the ordinary course of business will give rise to business income that becomes the income of the person under s CB 1 when the business income is "derived".

15. It is settled law that the word "derived" means more than merely received. It connotes the source or origin rather than the fund or place from which the income was taken, and means flowing, springing, or emanating from, or accruing: *CIR v NV Philips Gloeilampenfabrieken* [1955] NZLR 868 (CA).

16. It is also settled law that the timing of derivation and the method of accounting for income "should be that which is calculated to give a substantially correct reflex of the taxpayer's true income": *Commissioner of Taxes (SA) v The Executor Trustee and Agency Co of South Australia Ltd* (1938) 63 CLR 108 (HCA) (*Carden's Case*); *Philips; CIR v Farmers' Trading Co Ltd* [1982] 1 NZLR 449, (1982) 5 NZTC 61,200 (CA).

17. For most business taxpayers, the most appropriate method of accounting to give a substantially correct reflex of their business income will be the accrual method of accounting. This means income could be derived even if payment has not yet been received or an invoice rendered.

18. The general principle is that income is derived when it is earned and has "come home" to the taxpayer. This will be the point at which a legally enforceable debt arises or the right to be paid otherwise crystallises. In looking at whether a debt has been created, case law tends to show that this is in effect a two-stage enquiry. The first stage is to establish whether the parties have agreed, or a statute has imposed, when a debt is created. When this is clear, the income in question is derived for income tax purposes at that time. If there is no such agreement between the parties or statutory imposition, the general law must be considered to determine when a debt is created and when the income is derived.

19. The leading New Zealand case on the relevance of accounting principles and derivation is *Farmers' Trading*. This case dealt with when business profits were derived from trading stock sold where the customer paid the purchase price over a period of five months by way of monthly instalments. The issue was whether the income was derived at the time the stock was sold or whether a "profit emerging" approach could be used to spread the income over a period. It was held that the sales were fundamentally different to hire purchase sales. This was because the title and the property passed with the possession of the goods and the vendor could only sue for unpaid instalments. It was also held that the business profits were derived when the stock was sold and a debt in favour of the vendor was created.

20. Richardson J cited *Carden's Case* with approval. In particular, he restated that "the foundation of the accrual system is the view that the accounts should show at once the liabilities incurred and the revenue earned, independently of the date when payment is made or becomes due". His Honour stated at 61,208:

> The real question in this case is when trading profits are derived. Where a sale is made in the course of trade during the year any profit on sale must be recognised. That involves having regard to the debt arising in favour of the vendor and bringing it into account if it is practicable to do so.
>
> ...
>
> On sale of trading stock a debt arises in favour of the vendor. The stock leaves his account and prima facie the debt for which it was exchanged should be brought into

> account in its place. It is implicit in the legislation that trading debts cannot be ignored in the calculation of business profits and must be brought into account on a proper basis if that is feasible.
>
> ...
>
> [T]here may be no realistic way to reflect the debts in the trader's account. But in principle debts arising from sale of trading stock during an income year must be recognised in arriving at the profits derived in that year.

21. See, also, the Australian High Court case of *J Rowe and Son Pty Ltd v FCT* 71 ATC 4157, which is consistent with the principles expressed in *Farmers' Trading* in its rejection of the "profit emerging" approach.

22. The general principle that income is derived when it is earned, and that this is when there is an entitlement to payment or a legally enforceable debt, was also applied in *Hawkes Bay Power Distribution Ltd v CIR* (1999) 19 NZTC 15,226 (CA). In that case, Richardson P delivered the judgment of the Court of Appeal, which essentially agreed with Goddard J's conclusion in the High Court, that the taxpayer's income was derived when electricity was supplied by the taxpayer and used by its customers. The Court of Appeal considered that the income earning process was complete on supply and sale of the electricity to the consumer.

Section CB 2 – when trading stock is "disposed of"

23. Section CB 2 applies where a business disposes of trading stock either outside of the ordinary course of business or to put an end to the business, or a part of it. Where trading stock is disposed of together with other assets of a business, s EB 24 requires the total amount received to be apportioned between the trading stock and the other assets in a way that reflects their respective market values.

24. The question of when stock is "disposed of" becomes important when s CB 2 applies. This is a different question to when income is "derived". Section CB 2(4) defines "disposal" as including "the passing of property by an exchange, gift, distribution under a will or on intestacy". A disposal under ss FC 3 to FC 8 (which relate to distributions after death) that is not at market value is not included. The definition is silent on the timing of a disposal, but some guidance is given by case law and the SGA.

Sale of Goods Act 1908

25. Section CB 2(4)(a) states that disposal includes the passing of property by various means. The "passing of property" is a concept also used in the SGA. The SGA shows that a disposal or a sale of goods occurs when property in those goods passes to the purchaser.

26. Note that the SGA recognises a distinction between a "contract of sale of goods" and an "agreement to sell". There is a "contract of sale of goods" when a seller agrees to transfer property in the goods for a consideration called the "price". A sale occurs once the property in the goods is transferred from the seller to the buyer. In contrast, there is an "agreement to sell" when the transfer of property in the goods is to take place either at some future time or is subject to the fulfilment of some condition. A sale occurs either when the time elapses or the conditions are fulfilled.

27. The timing of when property in goods passes to a purchaser under the SGA depends on whether the goods are specific or unascertained. The

term "unascertained goods" is not defined in the SGA, but *Commercial Law in New Zealand* (online looseleaf ed, LexisNexis) states at [11.2]:

> ... it is clear that unascertained goods are those which are not identified and agreed on at all. Unascertained goods become ascertained goods once they are identified and agreed on in accordance with the contract.

28. Under s 18 of the SGA, no property is transferred in unascertained goods unless and until the goods are ascertained. Goods may be unascertained because they are:

- generic goods sold by description: *Re Gold Corp Exchange Ltd (In Rec)* [1994] 3 NZLR 385 (PC); or
- not yet severed from part of a larger bulk: *Re Wait* [1927] 1 Ch 606.

29. Specific goods are defined in s 2(1) of the SGA as "goods identified and agreed on at the time a contract of sale is made".

The timing when the parties agree

30. Sections 19(1) and (2) of the SGA provide that where there is a contract for the sale of specific or ascertained goods, the property in the goods is transferred from the seller to the buyer at the time the parties to the contract intended property to be transferred. When finding out the intention of the parties, regard should be had to the terms of the contract, the conduct of the parties, and the circumstances of the case. Accordingly, any explicit intention of the parties as to when property in the goods passes will be recognised as the date the sale occurs.

31. Other factors, such as whether the agreement for sale includes a reservation or retention of title clause, commonly known as a Romalpa clause, may be relevant. These clauses are designed to ensure that property in the goods is kept with the vendor until payment is received. Section 21 of the SGA sets out the rules for when property passes in these cases:

> *21 Reservation of right of disposal*
>
> (1) Where there is a contract for the sale of specific goods, or where goods are subsequently appropriated to the contract, the seller may, by the terms of the contract or appropriation, reserve the right of disposal of the goods until certain conditions are fulfilled.
>
> (2) In such case, notwithstanding the delivery of the goods to the buyer, or to a carrier or other bailee for the purpose of transmission to the buyer, the property in the goods does not pass to the buyer until the conditions imposed by the seller are fulfilled.
>
> (3) Where goods are shipped, and by the bill of lading the goods are deliverable to the order of the seller or his agent, the seller is prima facie deemed to reserve the right of disposal.
>
> (4) Where the seller of goods draws on the buyer for the price, and transmits the bill of exchange and bill of lading to the buyer together to secure acceptance or payment of the bill of exchange, the buyer is bound to return the bill of lading if he does not honour the bill of exchange, and if he wrongfully retains the bill of lading the property in the goods does not pass to him.

The timing when the parties' agreement is not evident

32. Where the parties either have not formed an intention as to when property passes, or have not clearly expressed their intention, s 20 of the SGA sets out five rules for determining when the property in the goods will be deemed to have passed. The first of these rules is considered the most common and relevant to trading stock. Section 20 states:

Rules for ascertaining intention

Unless a different intention appears, the following are rules for ascertaining the intention of the parties as to the time at which the property in the goods is to pass to the buyer:

Rule 1. Where there is an unconditional contract for the sale of specific goods, in a deliverable state, the property in the goods passes to the buyer when the contract is made, and it is immaterial whether the time of payment or the time of delivery, or both, is postponed.

Rule 2. Where there is a contract for the sale of specific goods, and the seller is bound to do something to the goods for the purpose of putting them into a deliverable state, the property does not pass until such thing is done, and the buyer has notice thereof.

Rule 3. Where there is a contract for the sale of specific goods in a deliverable state, but the seller is bound to weigh, measure, test, or do some other act or thing with reference to the goods for the purpose of ascertaining the price, the property does not pass until such act or thing is done, and the buyer has notice thereof.

Rule 4. Where goods are delivered to the buyer on approval, or on sale or return or other similar terms, the property therein passes to the buyer—

(a) when he signifies his approval or acceptance to the seller, or does any other act adopting the transaction:

(b) if he does not signify his approval or acceptance to the seller, but retains the goods without giving notice of rejection then, if a time has been fixed for the return of the goods, on the expiration of such time, and if no time has been fixed, on the expiration of a reasonable time. What is a reasonable time is a question of fact.

Rule 5.(1) Where there is a contract for the sale of unascertained or future goods by description, and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. Such assent may be expressed or implied, and may be given either before or after the appropriation is made.

(2) Where, in pursuance of the contract, the seller delivers the goods to the buyer, or to a carrier or other bailee (whether named by the buyer or not) for the purpose of transmission to the buyer, and does not reserve the right of disposal, he is deemed to have unconditionally appropriated the goods to the contract. [Emphasis added]

Date of disposal for s CB 2

33. There is no New Zealand case law on the effect of the SGA on s CB 2 (or its predecessors). The Australian Commonwealth Taxation Board of Review referred to the Australian Sale of Goods Act when deciding in *Case 18* (1946) 12 CTBR 120 that property had been disposed of by way of sale when the contract became unconditional. The issue in *Case 18* was whether the taxpayer's property had been "disposed of by sale or otherwise howsoever..." for s 36(1) of the Australian Income Tax Assessment Act 1936 (now s 70-85 of the Income Tax Assessment Act 1997). The Chairman of the Board of Review noted, in relation to the sale of goods, at 126:

> The ownership of the goods will be transferred by the contract itself (in which case, the contract is the sale) if the parties express that intention but where the parties form no intention as to the time when the property is to pass, or fail to express their intention, the time when the property passes is determined by certain statutory presumptions. Of these presumptions the only one which deems the property in the goods to pass when the contract is made arises where there is an unconditional contract for the sale of specific goods in a deliverable state. In view of these principles (... and most which are embodied in the Sale of Goods Act) it appears to me to be quite clear that the property in the goods which were included in the assets which were the subject of the contract under consideration did not pass from the taxpayer to the purchasers until 25 August 1943, when the last of the three necessary consents was given.

34. There is a similarity between the Australian and New Zealand Sale of Goods Acts that reflects their common United Kingdom origins. Also, the

trading stock provisions in the Australian Income Tax Assessment Act 1936 are similar in both their wording and treatment of trading stock to the equivalent New Zealand provisions. This means that, when dealing with the disposal of personal property, *Case 18* is authority for looking at non-tax legislation for guidance on when property is disposed of for tax purposes.

35. In *Hansen v CIR* [1972] NZLR 193, the Court of Appeal considered the precursor to s EB 24 (Apportionment on disposal of business assets that include trading stock). The issue was whether the Commissioner could determine the value of sheep sold as trading stock along with the other assets of the business, regardless of the parties having agreed a price for the sheep. Relevantly, the court gave effect to the intentions of the parties for when property in the stock passed. The purchaser was not allowed to shear the sheep before settlement. This suggested that the purchaser did not own the stock until settlement. The court concluded that settlement date was the appropriate date to value the sheep for the purposes of calculating their sale price. This was the date the parties intended property to pass to the purchaser and when the sheep were sold.

36. The general principle is that the date of sale (and, therefore, disposal) occurs when property in the goods passes. When an express intention of the parties as to when property passes can be found, that will be the date of sale. If no intention is expressed or can be found, the date of sale will be decided according to the statutory rules or presumptions contained in s 20 of the SGA (commonly the date an unconditional contract exists). Although not in the context of s CB 2, this general approach has also been upheld in tax cases that have referred to ss 19 and 20 of the SGA to decide when property has passed: *CIR v International Importing Ltd* [1972] NZLR 1,095 (CA); *Verryt v CIR* (1990) 12 NZTC 7,107 (HC).

37. Accordingly, for s CB 2, trading stock is "disposed of" when property in the goods passes. This will occur when the parties intend property to pass, where an express intention can be found. If no intention can be found, the statutory presumptions contained in Rules 1 to 5 of s 20 of the SGA will decide when property passes, and therefore when a sale or disposition occurs. Section 21 of the SGA may also be relevant where the contract includes a Romalpa clause.

38. Where s CB 2 applies to a disposal of trading stock, s CB 2(3) provides that the purchaser is treated as acquiring the trading stock for the amount that is treated as income of the vendor.

When a contract is unconditional

39. As Rule 1 of s 20 of the SGA relates to unconditional contracts, it is important to understand when a contract becomes unconditional.

40. An agreement becomes a binding contract when both parties to the contract have entered into binding obligations. A contract becomes unconditional when a binding contract is not subject to any conditions that may prevent the performance of the contract and the parties could sue for specific performance. A useful summary of the current state of New Zealand law on conditional contracts is in *Laws of New Zealand* Contract (online ed) at [154]:

> New Zealand Courts have developed a body of law concerning conditional contracts in which the term "condition" refers to a contingent condition; this is a provision in an agreement that contemplates that the legal effect of, or the parties' obligations under, the agreement will be altered in some way on the occurrence or

> non-occurrence of the contemplated contingency. In many older cases conditions were simply classified as "conditions precedent" or "conditions subsequent", a practice which led to real confusion in case law. The term "condition subsequent" is still commonly used without such a reference point and generally refers to a contingency which is to occur, or not, at some point after a binding contract has been entered and on which the continuation of contractual obligations depend; this means that a failure to fulfil the condition will bring the contract to an end at that point or will give to one or both parties the option to bring the contract to an end. The term "condition precedent" was particularly productive of confusion since a condition might be a contingency required to occur before an agreement came to have contractual force or alternatively a contingency which was to occur after the contract was entered into but before some aspect of performance was required. There has been judicial criticism of the use of the terms "condition subsequent" and "condition precedent" unless the discussion of the condition in question makes it clear what precisely it is that the condition is precedent to or subsequent to. It is therefore now more common for the Courts to concern themselves with the effect of the particular condition before them on the particular contract; however, it is possible to formulate general rules which indicate the likely effect of such common conditions as making agreements subject to contract or subject to finance or subject to solicitor's approval. [Footnotes omitted]

See also *Laws of New Zealand* Sale of Goods (online ed) [80] for a discussion of unconditional contracts under the SGA.

Financial arrangements rules

41. The ruling does not consider any potential operation of the financial arrangements rules in subpart EW. If the financial arrangements rules apply, the approach in the ruling will apply to any consideration that is effectively attributed as the value of the trading stock sold, as opposed to the total amount paid (where any difference is treated as interest under the financial arrangements rules).

Examples

42. The following examples are included to assist in explaining the application of the law.

Example 1 – Ordinary course of business – payment with possession

43. A customer enters a sporting goods store and purchases a tennis racquet, which comes with a 30 day money-back guarantee if not completely satisfied. The customer pays and leaves in possession of the goods.

44. The income from the sale is derived by the store in terms of s CB 1 on the day the customer purchases the tennis racquet. The tennis racquet is sold in the ordinary course of business and the income has been earned (and therefore derived), regardless of whether the customer returns at a later date seeking a refund under the guarantee.

Example 2 – Ordinary course of business – two instalments

45. On 12 March, a large appliance store and a customer sign a sale and purchase agreement for the sale of a refrigerator. The agreement allows for the refrigerator to be delivered that day on payment of a 25% deposit. The contract provides that risk passes to the customer on delivery of the refrigerator, but property does not pass until payment of the balance of the purchase price. Payment of the balance of the purchase price occurs one month later.

46. The income from the sale is derived in terms of s CB 1 on 12 March, as it is a sale of trading stock in the ordinary course of business. On that day, the income has been earned and a legally enforceable debt arose when the purchaser took delivery of the refrigerator.

Example 3 – Ordinary course of business – mail order

47. A customer makes a bulk order for photocopiers from an office equipment supplier by way of mail order from a catalogue description. The order is posted on 12 September and received by the vendor on 15 September. The photocopiers are taken from the vendor's warehouse and shipped on 20 September, with delivery to the customer taking place the next day.

48. The standard terms of sale are that risk, title and property in the goods pass when the goods are put onto the delivery truck. The photocopiers are delivered with an invoice showing payment is due on 20 October, which is when the customer pays for the photocopiers.

49. As this sale is made in the ordinary course of operating an office equipment supply business, the income from the sale is taxed under s CB 1. The income is derived on 20 September, when the trading stock is shipped. On that day the income has been earned and a debt has become due and enforceable under the terms of the sale.

50. If the sale conditions were that risk, title and property in the goods did not pass until delivery, the income would be derived on 21 September. In that situation, no debt is enforceable until delivery occurs.

Example 4 – Sale in course of closing down business

51. As in example 3, a customer places an order with the same standard terms of sale that property in the goods passes when the goods are put onto the delivery truck. However, for the purpose of this example, assume that the vendor is making the sale in the course of closing down the part of its business relating to office equipment, so that s CB 2 applies. As s CB 2 applies, the time of disposal of the trading stock is relevant, rather than when income from the sale of the trading stock would otherwise have been derived under s CB 1.

52. The order is for generic items that are unascertained goods at the time the order is made. The goods do not become specific goods until the particular photocopiers are identified as the customer's. Without any clear contractual intention to the contrary, this would occur on 20 September. On that day, the photocopiers are appropriated to the order or contract, property passes and a disposal occurs.

Example 5 – Sale in course of closing down business – reservation of title

53. As in example 4, a customer places an order in circumstances where it is assumed the vendor is making the sale in the course of closing down the part of its business relating to office equipment, so that s CB 2 applies. In this example, the terms of sale include a reservation of title clause that ensures the property in the goods does not pass until the goods are paid for in terms of s 21 of the SGA.

54. Despite the goods becoming specific goods when the photocopiers are appropriated to the order and are shipped on 20 September, property does not pass and a disposal does not occur until 20 October, when payment is made.

References

Expired Ruling

BR PUB 04/06 "Trading stock – tax treatment of sales and agreements to sell" *Tax Information Bulletin* Vol 16, No 5 (June 2004): 17

Subject references

Derivation of income

Time of sale

Trading stock

Legislative references

Income Tax Act 2007 ss CB 1, CB 2, EB 2, EB 24, and YA 1 (definition of "trading stock")

Sale of Goods Act 1908 ss 2, 3, 18, 19, 20 and 21

Case references

Case 18 (1946) 12 CTBR 120

CIR v Farmers' Trading Co Ltd [1982] 1 NZLR 449, (1982) 5 NZTC 61,200 (CA)

CIR v International Importing Ltd [1972] NZLR 1,095 (CA)

CIR v NV Philips Gloeilampenfabrieken [1955] NZLR 868 (CA)

Commissioner of Taxes (SA) v The Executor Trustee and Agency Co of South Australia Ltd (1938) 63 CLR 108 (HCA) (*Carden's Case*)

Hansen v CIR [1972] NZLR 193 (CA)

Hawkes Bay Power Distribution Ltd v CIR (1999) 19 NZTC 15,226 (CA)

J Rowe and Son Pty Ltd v FCT 71 ATC 4157 (HCA)

Re Gold Corp Exchange Ltd (In Rec) [1994] 3 NZLR 385 (PC)

Re Wait [1927] 1 Ch 606

Verryt v CIR (1990) 12 NZTC 7,107 (HC)

Other References

Commercial Law in New Zealand (online looseleaf ed, LexisNexis)

Laws of New Zealand (online ed)

Appendix — Legislation

1. Section CB 1(1) states:

CB 1 Amounts derived from business

Income

(1) An amount that a person derives from a business is income of the person.

2. Section CB 2 states:

CB 2 Amounts received on disposal of business assets that include trading stock

When this section applies

(1) This section applies in an income year when—

(a) a person (**person A**) who owns or carries on a business disposes of some or all of the assets of the business to another person (**person B**); and

(b) the disposal is made outside the ordinary course of the business, or to put an end to the business or a part of it; and

(c) the assets consist of or include trading stock of the business, or a share or interest in trading stock.

Assessable income of person A

(2) An amount that person A receives from the disposal of the trading stock is taken into account in determining their income for the income year. The amount is derived at the time of disposal referred to in subsection (1).

Price of acquisition by person B

(3) In the calculation of the taxable income of person B for the income year or a later income year, person B is treated as acquiring the trading stock for the amount of the disposal referred to in subsection (2).

Disposal

(4) In this section, a disposal—

(a) includes the passing of property by an exchange, gift, distribution under a will or on intestacy; and

(b) does not include a disposal under any of sections FC 3 to FC 8 (which relate to distributions after death) that is not at market value.

Relationship with section CB 1

(5) This section overrides section CB 1.

3. Section YA 1 defines "trading stock" as:

trading stock—

(a) is defined in section EB 2 (Meaning of trading stock) except for the provisions to which paragraphs (b) and (d) apply:

(b) in sections CG 6 (Receipts from insurance, indemnity, or compensation for trading stock), EB 24 (Apportionment on disposal of business assets that include trading stock), FB 13 (Trading stock), and GC 1 to GC 3 (which relate to the sale of trading stock for inadequate consideration),—

(i) includes anything produced or manufactured:

(ii) includes anything acquired for the purposes of manufacture or disposal:

(iii) includes livestock:

(iv) includes timber or a right to take timber:

(v) includes land whose disposal would produce income under any of sections CB 6 to CB 15 (which relate to income from land):

(vi) includes any thing for which expenditure is incurred and which would be trading stock if possession of it were taken:

(vii) does not include a financial arrangement to which the financial arrangements rules or the old financial arrangements rules apply:

(c) for the purposes of section GC 1 (Disposals of trading stock at below market value), has an expanded meaning as set out in section GC 1(4):

(d) in the old financial arrangements rules, is defined in section EZ 48 (Definitions)

4. Section EB 2 defines trading stock as:

EB 2 Meaning of trading stock

Meaning

(1) **Trading stock** means property that a person who owns or carries on a business has for the purpose of selling or exchanging in the ordinary course of the business.

Inclusions

(2) **Trading stock** includes—

(a) work of the following kinds that would be trading stock under subsection (1) if it were completed:

(i) partly completed work:

(ii) work in progress:

(b) materials that the person has for use in producing trading stock:

(c) property on which the person has incurred expenditure, when the property would, if they had it, be trading stock under subsection (1) or paragraph (a) or (b):

(d) property leased under a hire purchase agreement when the property—

(i) is treated as having been acquired by the lessor under section FA 15 (Treatment when agreement ends: seller acquiring property); and

(ii) is an asset of a business that the lessor carries on.

Exclusions

(3) **Trading stock** does not include—

(a) land:

(b) depreciable property:

(c) a financial arrangement to which the financial arrangements rules or the old financial arrangements rules apply:

(d) an excepted financial arrangement that a life insurer has:

(e) an excepted financial arrangement held by a person if section CX 55 (Proceeds from disposal of investment shares) applies to the income of the person from a disposal of the excepted financial arrangement:

(f) livestock not used in a dealing business:

(g) consumable aids to be used in the process of producing trading stock:

(h) a spare part not held for sale or exchange:

(i) an emissions unit:

(j) a non-Kyoto greenhouse gas unit.