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PUB00220: Draft Question We've Been Asked: Income Tax – Date of Acquisition of Land

Introduction

1. The New Zealand Law Society (Law Society) appreciates the opportunity to comment on *PUB00220: Draft Question We've Been Asked: Income Tax – Date of Acquisition of Land* (Exposure Draft).
2. The Law Society agrees with the majority of Inland Revenue's interpretation of the date of acquisition of land under section CB 15B. However, the Law Society considers that:
 - (a) Greater clarity is required about the date of acquisition for land that has been acquired and subsequently subdivided; and
 - (b) The analysis in respect of nominations is flawed. In most instances (such as nominating a family trust for nil consideration) there is no "disposal" of an estate or interest in land when a nomination is made. Moreover, Inland Revenue's analysis regarding nominations would give rise to outcomes that are not consistent with the intent of the legislation.
3. These points are discussed further below. Words not defined in this letter bear the meaning they have in the Exposure Draft.

Comments

Clarity is required that the date of acquisition of land that is subdivided is the date of acquisition of the original undivided piece of land

4. Under section CB 6A(2), for the purposes of the 2-year bright-line test, the acquisition date for land that has been acquired and subsequently subdivided is the acquisition date of the original undivided piece of land. According to the Exposure Draft:¹

¹ *PUB00220: Draft Questions We've Been Asked: Income Tax – Date of Acquisition of Land* at [21] and [25]. See also: "There are special rules about when the 2-year bright-line test in s CB 6A states. This is generally **not** the same date as the date you acquire land under s CB 15B." at [8].

... there are special rules about when you acquire land for the 2-year bright-line test. These rules differ from the rules about when you acquire land for the purposes of the other land provisions in the Act.

...

If you acquired land and subsequently subdivided it, the 2-year period for each of the resulting lots will start on whatever date it would have started for the original piece of land. The fact that there are separate new titles issued is not relevant.

5. The Exposure Draft does not deal with the general date of acquisition for land that has been acquired and subsequently subdivided. The implication of the Exposure Draft is that the acquisition date for land that has been acquired and subsequently subdivided would be different depending on whether or not the land comes within the 2-year bright-line test.
6. However, prior to the enactment of the 2-year bright-line test, and the Exposure Draft, the position seems to have been that subdivision of land did not reset the date of acquisition for that land. For example, in *Paul Stephens Constructions Limited v Commissioner of Inland Revenue* (1990) 12 NZTC 7,192, there is an implicit assumption in Gault J's judgment that the acquisition date for land that is subdivided is the acquisition date of the original undivided piece of land.
7. The date of acquisition of land that has been acquired and subsequently divided therefore now seems to be unclear.
8. In the Law Society's view, the assumption underlying the judgment in *Paul Stephens Constructions Limited v Commissioner of Inland Revenue* correctly reflects the legal position in relation to the date of acquisition of land that is subdivided – the subdivision does not reset the date of acquisition given that the land being assessed is the same underlying piece of land. The time at which the first interest in the freehold estate arose is the time at which the original undivided piece of land was acquired, and not at the point when the land was subdivided.
9. Boundary adjustments are a form of subdivision, and should have the same treatment as subdivisions for the purpose of assessing the acquisition date for land.
10. The Law Society seeks clarification in the Exposure Draft that the date of acquisition of land that is acquired and subsequently subdivided (including boundary adjustments) is the date of acquisition of the original undivided piece of land.

Nominations

11. The analysis underpinning the comments in paragraphs 36 to 42 regarding nominations is flawed and this section of the Exposure Draft should be rewritten.
12. In a typical nomination scenario, the nominator does not “dispose” of their equitable interest in land to the nominee. When a nomination is made, the nominator retains privity of contract with the vendor of the land (i.e. they retain their equitable interest in the land). Nothing is disposed of to the nominee. The nominee generally does *not* have privity of contract with the vendor; they have no interest in equity under which they could enforce the contract. Alternatively, where there is privity of contract under the terms of the nomination, the nominator still also retains an interest in land – and therefore cannot be said to have ‘disposed’ of their interest.

13. This can be contrasted with a novation, where the nominee steps into the shoes of the nominator and obtains an equitable interest.
14. The far-reaching consequences of the approach adopted in the Exposure Draft is illustrated by considering that if a nomination amounts to the disposal of an equitable interest in land then all of the land sale provisions in subpart CB would potentially apply to nominations.
15. In particular, in every instance where the buyer/nominator intended to make a nomination at the time they enter into a sale and purchase agreement (SPA), section CB 6 would apply to tax the gain/loss incurred between the date the SPA was entered into and the date the nomination is made.
16. Inland Revenue's own example appears to confuse this point. Taking Example 3 on pages 9 and 10:
 - (a) The example states that Alex and Angus entered into a SPA to buy an investment property **that they were planning to hold in a trust, but had not yet settled the trust when they found the property they wanted to buy**. This implies that they intend to make a nomination (dispose of the equitable estate in land, according to Inland Revenue's interpretation) as at the date the SPA is signed.
 - (b) The example then says that the bright-line test "potentially" applies to Alex and Angus's disposal of land (i.e. the nomination) "if none of ss CB 6 to CB 12 apply" and assuming the other section CB 6A criteria are satisfied. The example then explains on what basis Alex and Angus would be taxable if the section CB 6A bright-line test does apply.
 - (c) Given that the example begins by saying Alex and Angus always intended to make a nomination, it seems that section CB 6 (rather than section CB 6A) would apply to the "disposal".
17. This analysis gives rise to outcomes that are not consistent with the intent of the legislation.
18. These include:
 - (a) If the purchaser had an intention to nominate at the date the SPA is signed, the "disposal" is always taxable under section CB 6 (and we note this could equally give rise to a loss that could be offset against any other income of the nominator).
 - (b) If the purchaser did not have an intention to nominate at the date the SPA is signed, but subsequently nominates, then the "disposal" is taxable under section CB 6A if the nomination is made within 2 years (losses would be available, but ring-fenced), or not taxable at all otherwise.
 - (c) The Law Society is not convinced by Inland Revenue's analysis that CB 15 is not engaged because the estate in land ultimately sold by the nominee is different from that held by the nominator. At the time the estate is acquired by the nominee it is the same estate (an equitable estate). We have some difficulty with the concept that the fact that this changes to a legal estate in the hands of the nominee prevents CB 15 engaging. For example, if the sale of the legal estate was taxable, the nominee would be entitled to a deduction for any cost on acquiring the equitable estate – on the basis that this is essentially the same property.

- (d) If CB 15 was to apply based on our concerns in paragraph 18(c) above, then section CB 15(1) would cause the property to be held by the nominee on revenue account, merely because it was acquired through a nomination that was intended at the time the sale and purchase agreement was entered into. We do not think that this is intended by the legislation.

Losses on nomination

19. Paragraphs 40 and 41 suggest that a nomination will only result in tax consequences where the market value of the land has increased between the date the sale and purchase agreement was entered into and the date the nomination is made.
20. Assuming for the sake of argument that the nomination is in fact a taxable disposal, then a loss should be available where the market value of the land has decreased in that period. If the nomination is taxed under sections CB 6 – CB 12, then the loss could be offset against any other income of the nominator. If the disposal is only taxed under the bright-line test, then the loss would be ring-fenced so that it may only be used to offset taxable gains from other land sales.
21. If Inland Revenue’s interpretation stands, it poses a revenue risk where there is a downturn in the market, and creates an incentive for persons to use a nomination of a related party prior to settlement to recognise a loss on settlement of a long dated transaction.

RLWT on nominations

22. If a nomination is taxable under section CB 6A and the nominator is an “offshore RLWT person” as defined in section YA 1, the nominee presumably has RLWT withholding obligations where the nominator and nominee are associated persons.
23. In the event section CB 6A does potentially apply to a nomination, the Exposure Draft should provide a note to this effect to alert readers to this possibility. Separately, Inland Revenue should consider amending its commentary on RLWT to address the obligations for both the nominator and nominee (the nominator will be required to complete an RLWT declaration (IR 1101) in addition to the various RLWT obligations on the nominee).

Conclusion

24. This submission was prepared with assistance from the Law Society’s Tax Law Committee. If you wish to discuss this further please contact the committee convenor, Neil Russ, through the committee secretary Jo Holland (04 463 2967 / jo.holland@lawsociety.org.nz).

Yours faithfully



Kathryn Beck
President