

5 April 2016

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PUB00227: INCOME TAX – ARE PROCEEDS FROM THE SALE OF GOLD INCOME?

Introduction

1. The New Zealand Law Society appreciates the opportunity to comment on Inland Revenue's draft Question We've Been Asked: *PUB00227: Income Tax – Are proceeds from the sale of gold income?* (the **QWBA**).
2. The Law Society disagrees with the conclusion reached in the QWBA that gold bullion bought for investment purposes "*will necessarily be acquired for the purpose of disposal*" and therefore any proceeds from the sale will be income for income tax purposes under section CB 4 of the Income Tax Act 2007 (the **Act**). The Law Society also observes that there are some inconsistencies in the approach that is adopted in relation to various issues canvassed in the QWBA that need to be addressed before the QWBA is finalised.

Comments

Inconsistencies in approach throughout the QWBA

3. The QWBA (paragraph 4) reaches the conclusion that "*gold bullion bought as an investment will **necessarily** be acquired for the purpose of disposal and consequently any amounts derived on its disposal will be income*" under section CB 4. This conclusion is also reiterated in the body of the QWBA (paragraph 16) where it is stated that:

"In the case of investments in gold bullion, or gold units or certificates that do not pay interest or dividends, the Commissioner considers that the nature of the asset alone is enough to counter any assertion that it was not acquired for the purpose of disposal. Such a commodity does not provide annual returns or income while being held and has use or value only in its ability to be realised."
4. These statements, effectively suggesting that an acquisition of gold bullion will always be acquired with a dominant purpose of disposal, are difficult to reconcile with statements made later in the QWBA. In paragraph 20, for example, it is acknowledged that section CB 4 cannot apply "*if the taxpayer can establish they had no clear purpose when acquiring an asset*" (although doubts are expressed whether gold bullion can ever be acquired without a clear purpose in mind). Similarly, in paragraph 24, it is noted that gold bullion will "typically" be revenue account property.
5. This inconsistent approach can also be seen in the legal analysis in the QWBA. In paragraph 12, for example, the QWBA cites the English decision of *Wisdom v Chamberlain (Inspector of Taxes)* [1969] 1 All ER 332 (CA). The QWBA distinguishes this case and various other cases that

considered whether the sale of non-income producing assets can give rise to income, noting that the cases “*considered provisions that were different to CB 4*” (paragraph 13) and that “*None of the cases considered a provision akin to s CB 4*” (paragraph 14). Surprisingly, the QWBA then attempts to use the *Wisdom v Chamberlain* case, previously dismissed as not being relevant to section CB 4 determinations, to support the view that gold purchased as a hedge against inflation will still be held on revenue account.

6. It would be useful if the QWBA could be redrafted to remove these types of inconsistencies.

Australian case law on non-income producing assets is relevant and must be applied

7. As noted, the QWBA dismisses the relevance of various cases that have considered whether the sale of a non-income producing asset gives rise to income. One of those cases is the Australian decision of *Case Q109 83 ATC 560* (Board of Review). The issue in that case was whether section 26(a) of the Income Tax Assessment Act 1936 (AU) (the **ITAA**) applied to a purchase of silver, on the basis that the silver was acquired for the purpose of profit-making by sale.
8. The QWBA dismisses the relevance of this case, noting that “*there does not need to be a purpose of profit-making by sale*” for section CB 4 to apply (paragraph 14). However, this ignores the background to section CB 4. The predecessor to section CB 4 (together with certain other provisions now dealt with as separate sections of the Act) was enacted with the intention of being equivalent to section 26(a) of the ITAA. While there are some minor differences in terminology, the two provisions have always been interpreted by the courts and in the relevant commentary in a broadly similar manner (see the discussion in part 1 of John Prebble’s *The Taxation of Property Transactions* (1986) Butterworths).
9. Given this, it is not surprising to find that New Zealand courts, in interpreting section CB 4 (and its predecessors), have placed considerable reliance on Australian decisions on section 26(a) of the ITAA. There are numerous examples of the New Zealand courts referring to Australian cases dealing with section 26(a) to discern how section CB 4 should be interpreted in New Zealand.
10. For instance, the requirement that property must have been acquired with the “dominant” purpose of disposal before section CB 4 can apply comes from the Court of Appeal decision in *Walker v CIR* [1963] NZLR 339. In that case the Court of Appeal noted that the judge at first instance (whose findings the Court of Appeal upheld):

“[F]ollowed the judgment of Fullagar J. in *Pascoe v Federal Commissioner of Taxation* (1956) 6 AITR 315, holding that the “purpose” of which the section speaks is the dominant purpose in actuating the acquisition of the assets.”
11. The *Pascoe* case, dealing with the application of 26(a), is also applied in *CIR v National Distributors Ltd* (1989) 11 NZTC 6,346 (CA), the principal New Zealand case on which the QWBA relies.
12. For these reasons, the Law Society considers it is clear that any decision regarding the tax treatment of gold bullion under section CB 4 cannot properly be made without having regard to Australian case law dealing with the application of section 26(a) of the ITAA to non-income producing assets (such as *Case Q109*). Some of those cases have expressly considered the tax treatment that should be applied to gold and silver bullion (see discussion below) and should be referred to expressly in the QWBA.

Non-income producing assets are not always acquired with the dominant purpose of disposal

13. The QWBA takes the view that gold bullion bought as an investment will necessarily be acquired for the dominant purpose of disposal. However, this position is at odds with much of the Australian authority that has considered the tax treatment that should be applied to non-income producing assets. The relevant case law in this area indicates that in some circumstances non-income producing assets can be acquired without a dominant purpose of disposal, but that each case will ultimately depend on its facts.
14. In *Case Q109*, for example, one of the issues was whether two taxpayers had acquired silver bullion for the dominant purpose of profit-making by sale under the section 26(a) of the ITAA. The taxpayers in that case were a married couple who had recently migrated to Australia and purchased the silver as a long term investment for the benefit of their children. When the price of silver subsequently climbed from \$5 an ounce to \$30 an ounce in 1980, they sold half the silver.
15. The Board of Review hearing the case rejected the Commissioner's argument that the taxpayers had a dominant purpose of profit-making by sale. It held (page 565):

“[O]n the evidence which we accept, it emerges as the clear intention of both taxpayers that the silver bullion in question was purchased in March, April and in December 1978, as a long-term investment for the benefit of the children to be passed on to them either on the death of the taxpayers or when the children reached their maturity. **The evidence does not, in our opinion, support the proposition that the silver was purchased for any other purpose, including that of profit-making by sale.** The purchases were made at a time when the taxpayers were still facing difficulties associated with establishing a new life in Australia and at a time when the husband's health was a matter of grave concern. In the circumstances, the action taken to provide the children with a long-term investment can be seen to be consistent with the parents' plan of migrating to Australia in order that their children might have a happier and more secure future.”

[Emphasis added]
16. The Board of Review also expressly rejected an inference drawn by the Commissioner that silver bullion could only ever be acquired with a purpose of resale (page 565):

“The nature of the investment in the form of silver bullion is not seen as necessarily an impediment to that conclusion. The taxpayers by tradition were not strangers to the intrinsic value of silver, or of its uses, and in purchasing it as an investment for their children they were, they said, doing no more than following ancient custom...”
17. Another Australian decision to consider this issue was the decision of the Administrative Appeals Tribunal in *Case U145 87 ATC 844*. The taxpayer in that case purchased gold bullion as part of a diverse investment portfolio which also included industrial and mining shares, real estate and bloodstock. The gold bullion was purchased by the taxpayer on the recommendation of his stockbroker without a specific purpose in mind.
18. The Commissioner assessed the taxpayer to tax on profits he subsequently made from the sale of the gold bullion on the basis that it had been acquired for the purpose of profit-making by sale. The taxpayer rejected this argument and noted that at the time he purchased the bullion it was not his intention to sell it for a profit, but merely to incorporate its purchase as part of his overall investment portfolio which could be used, if needed, on his retirement or if he became unable to work through age and infirmity.

19. The Administrative Appeals Tribunal upheld the taxpayer’s argument and concluded that the gold had not been acquired with the purpose of profit-making by sale, finding that (page 850):

“we are therefore satisfied that, on the facts in this case, on the balance of probabilities the intention of the applicant at the time of the purchase of the bullion was to purchase it as a long-term investment and that the predominant purpose of that long-term investment was not sale for the purpose of profit-making. **Rather the applicant's intention was to retain the bullion as part of his long-term investments, as security for himself in case of future need and for his family on his death. The bullion would only be sold if a number of contingencies occurred.**” (paragraph 15)

[Emphasis added]

20. In citing the above authorities, the Law Society should not be taken as considering that non-income producing assets will never be acquired with the dominant purpose of disposal. To the contrary, there are a number of Australian cases where such assets have been held to have been acquired with a dominant purpose of profit-making through sale (see for example, *Case P27 82 ATC 117*, where a taxpayer was held to have acquired gold and silver bullion with the dominant purpose of profit-making by sale because the taxpayer always envisaged that the bullion would be realised upon his retirement).
21. The Law Society’s position is simply that it is not correct to suggest (as the QWBA currently does) that acquisitions of gold bullion will automatically have been acquired with a dominant purpose of disposal. Such an approach is inconsistent with the case law discussed above and the QWBA should be amended to reflect this.

Focus of section CB 4 is on the subjective intention of the taxpayer and not on the relevant asset disposed of

22. When section CB 4 is applied, the focus is on what purpose(s) (if any) the taxpayer had when the relevant asset was acquired. In the *National Distributors* case, for example, Richardson J commented that:

“It is well settled that the test of purpose is subjective requiring consideration of the state of mind of the purchaser at the time of the acquisition of property.”

23. While the QWBA acknowledges initially that the purpose of an acquisition must be determined subjectively (paragraph 11), this is largely ignored in the remainder of the analysis in the QWBA. The focus instead is almost exclusively on whether gold is an asset type that can be acquired other than with a dominant purpose of disposal.
24. The Law Society acknowledges that the nature of a particular asset is one matter that must be taken into account in determining whether the asset has been acquired with the dominant purpose of disposal (the *National Distributors* decision confirms this expressly). However, the focus of section CB 4 is still on the taxpayer’s subjective purpose in acquiring the relevant asset, regardless of the asset type. The type of asset acquired might be one factor suggesting that a taxpayer’s subjective purpose in acquiring an asset was disposal, but ultimately it is just one factor. Taxpayers acquire assets for a variety of different reasons. In some cases taxpayers will acquire gold with the hope and intention of never disposing of it, but to set aside the gold as a store of value outside of the monetary system, as a security measure in case of government instability affecting the banking sector and the availability of cash (such as the events affecting Greece), or a global economic crisis whereby precious metals such as gold would provide a proven source of wealth. Not all purchase decisions are reached on a rational basis and in some

cases a taxpayer may not have fully turned their mind to the question of why they have acquired a particular asset. Portfolio diversification is an example of this (such as in Case U145), where a taxpayer acquires gold with no clear purpose but merely to spread the risk of his or her investment. Where portfolio diversification is the key reason for acquiring gold, there are a number of possible scenarios, including still owning the gold at the time of death so that it can be passed on to heirs.

25. The Law Society notes that the *National Distributors* case outlines a variety of other factors (aside from the type of asset) that must be considered in determining whether a taxpayer subjectively had the purpose of acquiring an asset with the dominant purpose of disposal. These include the vocation of the taxpayer, the circumstances of the purchase, the number of similar transactions, the length of time the asset was held and the circumstances surrounding the use and disposal of the asset.
26. While acknowledging the relevance of these factors, there is no analysis in the QWBA that discusses how these factors might apply in relation to a taxpayer acquiring gold bullion, even though such factors could materially affect a determination regarding whether gold bullion has been acquired with the dominant purpose of disposal. It would be useful if the QWBA could be updated to address this.

Conclusion

27. This submission was prepared with the assistance of the Law Society's Tax Law committee. If you wish to discuss this further, please do not hesitate to contact the Tax Law committee's convenor Neil Russ, through the committee secretary Jo Holland (04 463 2967 / jo.holland@lawsociety.org.nz).

Yours sincerely

A handwritten signature in black ink, consisting of a stylized initial 'C' followed by a long horizontal line.

Chris Moore
President