

12 June 2019

Public Consultation
Inland Revenue Department
Wellington

By email: public.consultation@ird.govt.nz

Re: PUB00316: Income tax – When does the business premises exclusion to the bright-line test apply?

1. Introduction

1.1 The New Zealand Law Society (Law Society) welcomes the opportunity to comment on the draft Question We've Been Asked: *Income tax – When does the business premises exclusion to the bright-line test apply?* (exposure draft). Subject to the issues noted below, the Law Society considers the exposure draft reads well and the examples provided are appropriate and useful.

2. Meaning of “business premises”

2.1 The bright-line test in section CB 6A of the Income Tax Act 2007 (Act) taxes the sale of “residential land” within the bright-line period. The term “residential land” is defined in section YA 1 of the Act, and excludes land “used predominantly as business premises”. The term “business premises” is not defined for income tax purposes, other than for the purpose of subpart DD of the Act (which concerns the deductibility of entertainment expenditure). The definition of “business premises” for the purpose of subpart DD of the Act does not expressly require a building from which the business is carried on.

2.2 The meaning of the term “business premises” for the purpose of the definition of “residential land” was raised in submissions on the Taxation (Bright-line Test for Residential Land) Bill.¹ Officials in their report to the Finance and Expenditure Committee on that bill considered that defining “business premises” was neither necessary nor desirable given that it is meant to be applied in a wide range of circumstances. However, officials considered that “business premises” in the context of the bright-line test “... would include land, buildings, appurtenances, and parts of lands or buildings for use in the carrying on of a business”, consistent with the Commissioner’s conclusions on the meaning of the term “premises” for FBT purposes in what is now paragraph 41 of the Commentary on Public Rulings BR Pub 15/11

¹ NZLS submission 17.9.15 on the Taxation (Bright-line Test for Residential Land) Bill, at [18]; available at http://www.lawsociety.org.nz/data/assets/pdf_file/0019/134605/I-IR-Rental-Ring-fencing-revised-draft-30-4-19.pdf.

and BR Pub 15/12.² As such, officials did not consider that the existence of a building was a critical factor in determining what constitutes “business premises”.

- 2.3 Notwithstanding the officials’ comments, paragraph 7 of the exposure draft states that the so-called business premises exclusion will never apply to the sale of bare land, because the term “business premises” requires a building from which the business is carried on. Paragraph 12 of the exposure draft notes that, at common law, “business premises” can refer to a range of places from which a business is carried on, which can include bare land. However, the Commissioner considers that the ordinary usage of the term “business premises”, which refers to a building of some sort together with the land from which the business is carried on, should be preferred in interpreting the definition of “residential land” for the purpose of section CB 6A of the Act.
- 2.4 Paragraph 13 of the exposure draft sets out the reasons why the Commissioner considers that the ordinary usage of the term “business premises” (which seems to require a building of some sort) should be preferred to the common law meaning of the term “business premises” (which is somewhat wider and can include bare land). In essence, the Commissioner considers that section CB 6A’s focus on land that has, or is capable of having, some sort of residential building on it somehow has a bearing on the meaning of “business premises”. The Commissioner also considers that the term “business premises” in the definition of “residential land” should be interpreted consistently with the Commissioner’s view of the meaning of “business premises” in section CB 19 of the Act (the business premises exclusion that applies for the purpose of sections CB 6 to CB 11 of the Act).
- 2.5 The Law Society questions whether “business premises” should be interpreted restrictively to require a building of some sort to have been erected on the land in question, because:
 - a. Officials’ comments on page 26 of the Officials’ Report to the Finance and Expenditure Committee on the Taxation (Bright-line Test for Residential Land) Bill provided a wide interpretation of “business premises”.
 - b. It would have the effect of excluding businesses that do not operate from a building. For example, it is illogical that the so-called business premises exclusion would apply to a scrap metal yard which includes a site office, and not to a scrap metal yard that does not include a site office but does include other types of land improvements, such as security fencing and roading.
 - c. It is not clear that the scope of the bright-line test, which explicitly applies to bare land, has any bearing on the interpretation of “business premises”.
 - d. It is unclear whether the meaning of “business premises” for the purpose of section CB 19 of the Act necessarily requires a building of some sort, for the reasons set out in the Law Society’s letter on draft Question We’ve Been Asked: *Income tax – When does the business premises exclusion under s CB 19 apply?*

² Officials’ Report to the Finance and Expenditure Committee on the Taxation (Bright-line Test for Residential Land) Bill, at p26. Available at <https://www.classic.ird.govt.nz/resources/1/d/1d50ec55-ee56-4ce4-897a-ec23373331ad/pu1511-1512.pdf>.

3. Examples

- 3.1 Example 1 concerns a dentist, Raj, who sells a villa which he uses for his dentist practice three years after purchasing it. Example 1 should make it explicit that Raj purchased the villa on or after 29 March 2018. Otherwise, the 5-year bright-line period would not apply, and it would not be necessary to consider whether the villa meets the definition of “residential land”.

4. Typographical errors

- 4.1 The exposure draft contains the following minor typographical errors:
- a. There should not be a comma after the word “location” in the fourth line of paragraph 15.
 - b. The word “where” in the first line of the fourth bullet point in paragraph 24 should be replaced with “whereas” or “while”.
 - c. There should be a closed quotation mark after the word “land” in the second line of the second paragraph of Example 4.

5. Further information

- 5.1 These comments were prepared by the Law Society’s Tax Law Committee. If you have any questions, please contact the committee convenor, Neil Russ, via Law Reform Adviser, Emily Sutton (emily.sutton@lawsociety.org.nz / (04) 463 2978).

Yours faithfully

A handwritten signature in black ink, appearing to read 'Herman Visagie', written over a large, light-colored oval shape.

Herman Visagie
Vice President