

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 under s CB 19 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 under s CB 19 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 “premises of a business”

2.1 The “business premises exclusion” in section CB 19 of the Income Tax Act 2007 (Act) applies to land that is the premises of a business and which the person acquired and occupied, or erected and occupied, mainly to carry on a substantial business from them.

2.2 The term “premises of a business” is not defined for income tax purposes, although the term “business premises” is defined 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.

2.3 Paragraph 6 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 appears to require a building of some sort, should apply for the purpose of section CB 19.

2.4 Paragraph 7 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 a narrow interpretation of the term “business premises” is consistent with the wording of section CB 19(1)(b) of the Act, which includes the words “erected and occupied”. Further, the Commissioner considers that such an interpretation is consistent with wording of the residential exclusion in section CB 16 of the Act, which explicitly requires a dwellinghouse to be erected on the land.

- 2.5 It is not clear that the term “premises of a business” should be interpreted restrictively to require a building of some sort to have been erected on the land in question. The reasons for this are as follows:
- a. Such an interpretation would have the effect of excluding businesses that do not operate from a building. For example, it is illogical that the 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.
 - b. It does not follow that the inclusion of the words “erected and occupied” in section CB 19(1)(b) means that the term “premises of a business” should be interpreted restrictively to exclude land that does not have a building erected on it. Section CB 19(1)(b) refers to premises that a person acquires and occupies *or* erects and occupies. These are alternatives, which means that the business premises exclusion can apply where a person acquires and occupies premises from which they carry on a substantial business, even if that person does not erect anything on the premises. Further, a person can occupy a premises without a building being erected on the land. For example, a person can occupy a scrap metal yard or quarry whether or not a site office is erected on the land. Even if section CB 19(1)(b) did require something to be erected on the land, then presumably something less than a building, such as fencing, would suffice. If Parliament intended that section CB 19 would apply only to land with a building erected on it, then the wording of section CB 19 would have explicitly stated that.
 - c. It is not clear that the wording of the residential exclusion in section CB 16 of the Act has any bearing on the interpretation of “premises of a business” for the purpose of section CB 19 of the Act. These provisions operate independently of each other and are governed by their express terms. Section CB 16 explicitly requires the land to have a dwellinghouse on it. Section CB 19, in contrast, makes no reference to a building of any kind, and none can be implied.

3. Time at which land must be used as “premises of a business”

- 3.1 It would be helpful if the exposure draft made it clear that the business premises exclusion could apply even if the land is not used as the premises of a business immediately before the land is sold.
- 3.2 The exposure draft does not consider the time at which the land is required to be used as premises of a business. Section CB 19(1) of the Act requires that the land “is” the premises of a business, while its predecessor, section CD 1(3)(a) of the Income Tax Act 1994, required that the business “was” carried on by the person on the land. In contrast, the farmland exclusion in section CB 21 of the Act requires that the land was occupied or used for the purposes of a farming or agricultural business “immediately before” the land was divided (the only exclusion to include such a definitive requirement).
- 3.3 Sections ZA 3(3) and ZA 3(4) of the Income Tax Act 2007, along with sections YA 3(3) and YA 3(4) of the Income Tax Act 2004, require post-rewrite income tax provisions to be interpreted consistently with the equivalent pre-rewrite income tax provisions, except where there has been an identified policy change (not the case in terms of section CB 19 of the Act) or the post-rewrite income tax provision has subsequently been amended (also not the case

for section CB 19 of the Act). As such, section CB 19 of the Act should be interpreted consistently with section CD 1(3)(a) of the Income Tax Act 1994.

- 3.4 Section CD 1(3)(a) of the Income Tax Act 1994 stated that the business premises exclusion applied to premises from which substantial business *was* carried on by the taxpayer. The word “was” does not connote any immediate proximity between the use of the land as business premises and the sale of that land (unlike the farmland exclusion in section CB 21 of the Act, which requires that the land was occupied or used for the purposes of a farming or agricultural business *immediately before* the land was divided). As such the business premises exclusion in section CB 19 of the Act could apply even if the land is not used as the premises of a business immediately before the land is sold.
- 3.5 It is not uncommon for business owners to sell their former business premises on a “vacant possession” basis, where the business has relocated to more suitable premises before the former business premises is sold. It is unclear why the business premises exclusion in section CB 19 of the Act would not apply in this instance.

4. Guidance on what constitutes a “substantial business”

- 4.1 Section CB 19(1)(b) of the Act requires that the business the landowner carried on from the business premises was “substantial”. Paragraph 15 of the exposure draft notes that whether a business is “substantial” is a question of fact, and relates to the size and scale of the business, not the amount of time or effort the landowner commits to the business. The exposure draft does not, however, provide any guidance on what the Commissioner considers is or is not a “substantial business” for the purpose of section CB 19. It would be helpful for the exposure draft to provide further guidance on this issue.

5. Business premises sold at a loss

- 5.1 Paragraph 26 of the exposure draft notes that if a landowner sells land covered by section CB 19 of the Act at a loss, then the loss will be capital in nature and, therefore, not deductible. The Law Society notes this will not necessarily be the case where, for example, the landowner is also taxable on the sale of the land under some other taxation provision to which the business exclusion in section CB 19 of the Act does not apply.
- 5.2 For example, where the business premises is sold as an ordinary incident of the landowner’s business, the sale of the land will be taxable under section CB 1 of the Act. Alternatively, where the business premises is sold as part of an undertaking or scheme entered into for the purpose of making a profit, the sale of land will be taxable under section CB 3 of the Act. In either case, any resulting loss will not be capital in nature, and the loss will be deductible despite the fact that the sale would not have been taxable under sections CB 6 to CB 11 of the Act due to the application of the business premises exclusion in section CB 19 of the Act.

6. Examples

- 6.1 Example 1 considers the application of the business premises exclusion to land that has been leased to another person who carries on a substantial business from that land. Paragraph 2 of Example 1 notes that the sale is taxable under s CB 10(2) of the Act “because MHL is associated with MDL, a property developer”. MHL’s land will only be tainted by association with MDL if MHL and MDL were associated persons at the time MHL acquired the commercial

property and MDL was carrying on a property development business at that time. The facts of Example 1 should be amended to make this explicit.

- 6.2 Example 3 considers the application of the business premises exclusion to land used as a scrap metal yard where no building has been erected on the land. For the reasons set out in paragraph 2.5 above, we consider that the business premises exclusion in section CB 19 of the Act would apply in this situation and that the conclusion in Example 3 is not correct.

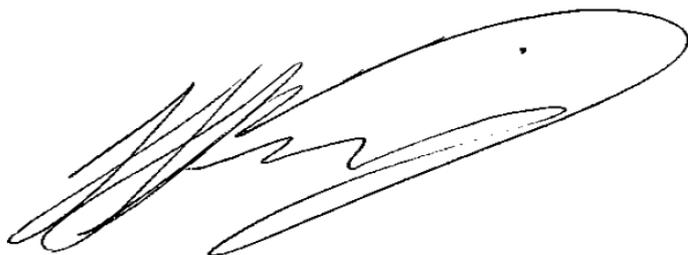
7. Typographical error

- 7.1 The word “where” in the first line of the fourth bullet point in paragraph 27 of the exposure draft should be replaced with “whereas” or “while”.

8. Further information

- 8.1 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 be 'Herman Visagie', written over a large, light-colored oval shape that serves as a background for the signature.

Herman Visagie
Vice President