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Habitual buying and selling of land
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Inland Revenue Department
Wellington

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Tax policy consultation – Habitual buying and selling of land

Introduction

1. The New Zealand Law Society (Law Society) welcomes the opportunity to comment on the tax policy consultation document: *Habitual buying and selling of land* (Paper).
2. The Paper proposes a number of amendments to the exclusions from the land sales rules set out in sections CB 16 and CB 19 of the Income Tax Act 2007 (Act), which are intended to address concerns that taxpayers who habitually buy and sell land can structure around the “regular pattern” restrictions on the application of those exclusions.

Comments

General comments

3. The proposals in the Paper are intended to address concerns that taxpayers are structuring land transactions in order to access the exclusions from the land sales rules set out in sections CB 16 and CB 19 of the Act by:
 - acquiring successive properties through separate but associated persons or arrangements, as the restrictions to the exclusions apply narrowly to the activities of a single person; and/or
 - carrying on different activities on each piece of land acquired, so as to avoid a similarity or likeness between the transactions that could constitute a pattern of activity,

and so bypassing the restrictions on the availability of those exclusions.

It is unclear from the Paper whether any information is available as to the scale of any potential problem in this regard. In particular, in relation to the concern that taxpayers are acquiring successive properties through separate but associated persons or arrangements, the Law Society understands from practitioners that this is rarely encountered in practice.

4. As discussed in more detail below, the Paper proposes to address these concerns by broadening the currently-narrow focus of the restrictions. The ambiguity inherent in drafting what is essentially a “catch-all” restriction on the availability of a specific legislative exclusion could lead to unintended consequences and significant commercial uncertainty for taxpayers. This should be borne in mind if the proposals in the Paper are to progress.
5. The Law Society recommends that Inland Revenue consider whether implementation of the proposals will place any further monitoring or reporting obligations on lawyers and

conveyancers. The Law Society understands from practitioners that the rapid increase in the regulatory compliance responsibilities of lawyers and conveyancers in recent years (such as those relating to anti-money laundering, Overseas Investment Act matters, the consideration and collection of residential land withholding tax and related statements, Authority and Instruction forms and the associated identity verification requirements) is making even low-risk “standard” land transactions such as the sale or purchase of the family home increasingly difficult and expensive for consumers.

Group of persons or entities

6. The Paper proposes that the restrictions on the exclusions set out in section CB 16 and section CB 19 be expanded so that they apply not only to the activities of a single person, but also to groups of people or entities that are associated and together or through entities that they control have a pattern of buying and selling properties that they all occupy as their main home, residence or business premises. This is intended to resolve the concern that taxpayers may circumvent the application of the “regular pattern” restrictions by buying and selling land using different but associated persons or entities to hold each property. This proposal has the potential to create significant ambiguity and commercial uncertainty for taxpayers, as illustrated by examination of the examples given following paragraph 11 of the Paper.
7. In example 1, Mr and Mrs A are described as purchasing rundown residential properties to live in while they renovate, and then ultimately sell those properties. However, in fact, of the five properties that they are said to have dealt with in this way, the first was held in Mr A’s name, the second was held in Mrs A’s name, the third was held in the name of the A Family Trust, the fourth in Mr A’s name and the fifth in the name of the A Property Trust. Mr and Mrs A are said to “control” the A Family Trust and the A Property Trust. As a result, it is said that the regular pattern restriction in section CB 16 would apply to this scenario under the proposal because a group of people has engaged in a regular pattern of buying and selling various properties, each of which was occupied as a residence or main home by Mr and Mrs A. The Law Society considers that the proposed definition of “control” is not clear in this context, and therefore there is a significant risk that unintended consequences may flow from attempting to define that term. For example, if a person is said to “control” a trust because they are a trustee, then independent trustees may be unintentionally (and improperly) captured. Additionally, as a point of technical accuracy, the example does not reflect that title to land is not registered in the name of a trust, but rather in the names of its trustees (or trust board).
8. Example 2 states that “G Purchases” rundown buildings out of which he runs a piano tuning business. However, later in the example, it transpires that G has not in fact purchased the buildings – each building has been purchased by a separate company that is wholly-owned by G. The conflation of the separate legal personalities of G on the one hand and the various land-owning companies on the other robs the example of force, as it ignores the legal reality. Moreover, in circumstances where a property is owned by a company and G, a different person, operates a business out of that property, the business premises exclusion set out in section CB 19 would not be available under current law, given that section CB 19(1) requires not only that the land is the premises of a business but *also* (per section CB 19(1)(b)) that the person [disposing of the land], that is to say, the owner of the land) acquired and occupied, or erected and occupied the premises mainly to carry on a substantial business from them. The “regular pattern” restriction on the business premises exclusion is therefore irrelevant

where, as here, the owner of the land and the person carrying on the business are different people.¹

9. The combination of examples 3 and 4 with paragraph 12 of the Paper gives the erroneous impression that the application of the “regular pattern” restriction turns on whether the taxpayer (or group of associated taxpayers) acquires the subject properties with an intention of resale. Rather, where a taxpayer holds land on capital account (as is the case in example 3) then neither the residential exclusion set out in section CB 16 of the Act nor the business premises exclusion set out in section CB 19 of the Act come into play, so it is not necessary to consider whether the regular pattern restriction on the use of those exclusions applies. It would be helpful if the proposals set out in this part of the Paper reflect more clearly that it is necessary to consider whether a transaction is *prima facie* taxable before going on to consider whether any exclusions apply.

Similar activities

10. It is proposed that the “regular pattern” restrictions be amended so that they apply broadly to all patterns of buying and selling land used as a residence or as business premises. Any proposed legislative amendments following this Paper should avoid creating ambiguity or commercial uncertainty for taxpayers.

Time period restrictions

11. It is proposed at paragraph 18 of the Paper that “time period restrictions” akin to those currently contained in section CB 16A of the Act could be added to section CB 16 and CB 19 of the Act in addition to the “regular pattern” restrictions. It is further proposed that such new time period restrictions could apply to disposals more than twice in three years (as opposed to the more-than-twice-in-two-years restriction that applies to the disposal of the main home for the purposes of the exclusion from the bright-line test currently contained in section CB 16A).
12. The rationale for why any potential time period restrictions to be added to section CB 16 and section CB 19 should differ from the time period restrictions currently contained in section CB 16A is unclear. It is difficult to see why there should be any difference between the main home exclusion (section CB 16A) and the residential property and business premises exclusions in section CB 16 and section CB 19 respectively, and suggests that any time period restrictions should be consistent in order to avoid unnecessary complexity and confusion for taxpayers.

Other matters

13. The Law Society agrees that, as set out in paragraph 21 of the Paper, the “regular pattern” restrictions should not apply in the event of change of circumstances. However as with examples 3 and 4, discussed at paragraph 9, above, we are concerned that paragraph 21 erroneously implies that where land is held on capital account and disposed of simply due to a change of circumstances or in response to the needs of a growing business, any gains on such disposition are or would be *prima facie* taxable unless one of the various exclusions applies.

¹ Although it is outside the scope of the proposals set out in the Paper, it is worth noting that this arrangement would have other tax implications, given that G is a shareholder benefitting from company assets.

Section CB 15(1)

14. Although outside the scope of the Paper, the Law Society wishes to express its concern in relation to a separate but related issue - the unintended and inappropriate tax outcomes resulting from the recent (retrospective) amendment to section CB 15(1) of the Act, so that it is an independent charging provision. We understand that this issue has been raised previously.
15. At present, a person may be able to apply the residential exclusion contained in section CB 16 of the Act in some situations (for example, where they carry out property development in their own name and retain one of the sections for use as their home), but not in others with the same overall effect (for example, where the person decides for good commercial reasons to carry out property development through a company, which transfers one of the lots to the person who uses it as their home).
16. Apart from the fact that this means that the tax outcome may drive the manner in which property developments are carried out (undesirable), making section CB 15(1) an independent charging provision has led to a problematic situation in which the deductions in section DB 27 of the Act (which are only available where a person derives income as a result of section CB 13 and, critically, not CB 15) and section DB 28 of the Act (which are only available where a person derives income as a result of section CB 13 and, again, not section CB 15) are unavailable to the transferee where land deemed to be held on revenue account due to either of sections CB 13 or CB 14 of the Act is transferred to an associated person.

Further assistance

17. We trust Inland Revenue will find these comments helpful. If you wish to discuss the comments, please do not hesitate to contact the Tax Law Committee convenor Neil Russ, through the Law Society's Law Reform Adviser, Emily Sutton (Emily.Sutton@lawsociety.org.nz).

Your faithfully



Herman Visagie
Vice President