

30 May 2016

Team Manager, Technical Services
Office of the Chief Tax Counsel
National Office
Inland Revenue Department
PO Box 2198
Wellington

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

Draft Question We've Been Asked, "Income Tax - Land Sale Rules - Main Home and Residential Exclusions - Regular Pattern of Acquiring and Disposing, or Building and Disposing"

Introduction

1. The New Zealand Law Society appreciates the opportunity to comment on *Draft Question We've Been Asked, "Income Tax - Land Sale Rules - Main Home and Residential Exclusions - Regular Pattern of Acquiring and Disposing, or Building and Disposing"* (the QWBA).
2. The QWBA addresses the question what is meant by the words "*regular pattern*" (involving the disposal of land) for the purposes of sections CB 16 and CB 16A of the Income Tax Act 2007.
3. For the reasons set out below, the Law Society recommends that the QWBA be reformulated into parts to deal with sections CB 16 and CB 16A separately. There also needs to be greater consistency with the language used: to avoid unnecessary confusion, the language should be consistent with the wording of sections CB 16 and CB 16A.

Comments

Structure and clarity of the QWBA

4. Both sections CB 16 and CB 16A provide exclusions from the land sale rules where the person is disposing of their home or residence. Section CB 16 applies as an exclusion to the application of sections CB 6 to CB 11, and section CB 16A applies specifically to the application of section CB 6A.
5. The exclusions under sections CB 16 and CB 16A, respectively, do not apply where:

*a person "has engaged in a **regular pattern** of acquiring and disposing, or erecting and disposing, of dwellinghouses"*¹

¹ Section CB 16(3) Income Tax Act 2007.

a person “has engaged in a **regular pattern** of acquiring and disposing of residential land”²

6. The QWBA is intended to clarify the meaning of the words “*regular pattern*” for the purposes of sections CB 16 and CB 16A.
7. Given the words “*regular pattern*” (involving the disposal of land) are the only similarities between these two provisions, the focus of the QWBA should be on the meaning of the words “*regular*” and “*pattern*” and the composite term “*regular pattern*”.
8. The QWBA, however, goes further than this and attempts to explain when the exclusions in section CB 16 and CB 16A are likely, or not likely, to apply. As a consequence, the QWBA is more complicated than it needs to be and risks being misunderstood by its intended audience.
9. Confusion may arise as the language used in section CB 16A refers to a person’s “*main home*” whereas section CB 16 is concerned with a “*dwellinghouse occupied mainly as a residence*”. Further, the rules relating to the application of the “*main home*” exclusion differ from the rules which relate to determining whether a person has occupied a “*dwellinghouse mainly as a residence*”.
10. The QWBA would be clearer if it were divided into three separate parts, with:
 - a. the first part dealing with the definitions of the words “*regular*”, “*pattern*” and “*regular pattern*”;
 - b. the second part dealing with the application of the meaning of the words “*regular pattern*” in the context of section CB 16; and
 - c. the third part dealing with the application of the meaning of the words “*regular pattern*” in the context of section CB 16A.
11. The Law Society also considers it should be made clear that section CB 6A (and consequently section CB 16A) applies only in the event that none of sections CB 6 to CB 12 apply.^{3,4} We recommend that the QWBA be reworked so the reader is aware of the requirement to have considered the application of sections CB 6 to CB 12 and the relevant exclusion in section CB 16 (which is specific to sections CB 6 to CB 11) before considering the application of section CB 6A and the exclusion in section CB 16A.
12. As stated above, there are clear differences between the language used in each of sections CB 16 and CB 16A. The requirements for establishing that a residence is a “*main home*” for the purposes of section CB 16A differ from the requirements for establishing that a person has occupied a dwellinghouse “*mainly as a residence*” for the purposes of section CB 16.
13. For example, to qualify as a “*main home*” the land must have been used “*predominantly, for most of the time*” by the person who owned the land for a “*dwelling*” that was the “*main*

² Section CB 16A(2)(b) Income Tax Act 2007.

³ Section CB 6A(6) Income Tax Act 2007.

⁴ Note that even though section CB 6A does not apply in the event sections CB 6 to CB 12 apply, the exclusion in section CB 16 does not apply to section CB 12.

home” of the person or a beneficiary of a trust that owned the land. To be used predominantly as a “*main home*”, most of the area of the land must have been actually used for the home.⁵ The test is based on a person’s actual use of the property and not the person’s intended use of the property.⁶ “*Used for most of the time as their main home*” requires the property to have been used more than 50 percent of the time as their main home for the period the person owns the land.⁷

14. By contrast, section CB 16 requires that for the exclusion to apply, the person must have acquired the land either with a dwellinghouse on it or to be erected on it, and the dwellinghouse must have been occupied mainly as a residence for the person and their family living with them. There is no requirement under section CB 16 for the person to establish that they used the property for a particular length of time as a residence or that most of the area of the land on which the dwelling was situated was used as a residence.
15. Different rules also apply where the land in question is owned by a trust and occupied by a beneficiary of a trust. Section CB 16A requires that the exclusion can apply only where the principal settlor does not have another “main home”, and the section provides a definition of what constitutes a “principal settlor”. By contrast, section CB 16 requires only that where the property is owned by a trust, the property must have been occupied by a beneficiary of that trust as their residence.
16. Given the different language and definitions that apply to sections CB 16 and CB 16A, the Law Society considers it would be preferable for the QWBA to address separately how the term “*regular pattern*” applies in respect of each of these sections.

Other changes to improve consistency and clarity

17. The Law Society also recommends that a number of other minor amendments be made to the QWBA for the purpose of clarifying the provision being referred to. These suggested amendments are set out in paragraphs 18 to 27 below.
18. The QWBA should make it clear at the outset that:
 - there are a number of provisions in the Income Tax Act 2007 (namely sections CB 6A to CB 14) that tax gains on the sale or disposal of land; and
 - there are a number of exclusions (including a number of exclusions for residential land) that apply in relation to the application of those taxing provisions; but
 - the QWBA only concerns the meaning of the words “*regular pattern*” which appear in section CB 16, which provides an exclusion to sections CB 6 to CB 11 (“*the residence exclusion*”), and section CB 16A, which provides an exclusion to section CB 6A (“*the main home exclusion*”).

⁵ Tax Information Bulletin Volume 28, No 1, February 2016 (at p84).

⁶ Ibid.

⁷ Ibid.

The terms “*the residence exclusion*” and “*the main home exclusion*”, once clearly defined, should be used consistently throughout the QWBA.

19. The reference in paragraph 7 to “*houses*” should be to “*dwellinghouses*” to correctly reflect the language of section CB 16.
20. The reference in paragraph 10 to “*home or residence exclusion*” should be to the “*main home exclusion or the residence exclusion*”.
21. In paragraph 13 we recommend that the words “*For the purposes of section CB 16A*” be added to the beginning of the second sentence.
22. In paragraphs 16 and 17, the word “*house*” should be replaced with the word “*dwellinghouse*” (where it relates to section CB 16) and “*dwelling*” (where it relates to section CB 16A), to correctly reflect the wording of sections CB 16 and CB 16A.
23. To ensure consistency, any reference to the “*home or residence exclusion*” (for example in paragraph 35 and Example 3) should be amended to refer to the “*main home exclusion or the residence exclusion*”.
24. Again, to ensure consistency with the wording of the legislation, in paragraph 20 the term “*erecting and disposing of*” should be used instead of “*building and disposing of*” and “*dwellinghouses*” should be used instead of “*houses*”.
25. Paragraph 23 should be amended by removing the words “*the greater the presumption*” and replacing them with the words “*the more likely*”. If put on enquiry, the taxpayer has the burden of proving that the transactions entered into by them have not resulted in a regular pattern of “*acquiring and disposing or erecting and disposing*” (in the context of section CB 16) or “*acquiring and disposing*” (in the context of section CB 16A). Neither of these provisions refer to a presumption that the person has established a regular pattern unless proved otherwise. We also recommend the word “*regular*” in paragraph 23 be omitted. The sale of one or more properties may well constitute a pattern but it does not follow, in the absence of other evidence, that a number of similar transactions results in the pattern being regular.
26. The Law Society does not agree with the wording in paragraph 35 which states “*If you sold more than that, for whatever reason, there may be a question of whether you have a regular pattern*”. The sale of two properties could never constitute a “*regular pattern*”, resulting in the inability to apply the “*residence exclusion*” or the “*main home exclusion*” to the sale of a third property. Case law (and, in particular, the *Parry*⁸ decision) indicates that the sale of at least three properties is required to constitute a “*regular pattern*” (although in *Parry* it was held that there was no “*regular pattern*” on the facts, as the “*pattern*” was not “*regular*”).
27. As stated above, not separating the QWBA into parts to deal with sections CB 16 and CB 16A separately means that references throughout the QWBA to “*home*”, “*house*” and “*residence*” are confusing and could, in some instances, lead the reader to the wrong conclusion.

⁸ Parry v CIR (1984) 6 NZTC 61,820

Conclusion

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

Yours faithfully

A handwritten signature in black ink, appearing to be 'Kathryn Beck', written in a cursive style.

Kathryn Beck
President