KPMG
10 Customhouse Quay
P.O. Box 996
Wellington
New Zealand

Telephone +64 (4) 816 4500
Fax +64 (4) 816 4600
Internet www.kpmg.com/nz

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

Our ref 160408KPMGSubCB4

8 April 2016

Dear Sir or Madam:

KPMG Submission - PUB00227: Are Proceeds from the Sale of Gold Income?

KPMG is pleased to make a submission on the above draft Question We've Been Asked ("QWBA") item.

Comments marked up in the draft QWBA

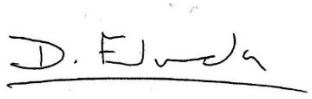
In the interests of time and, for ease of your reference, we have marked up the QWBA item for our comments. This is attached below.

KPMG has made a submission on *PUB00260: Land acquired for a purpose or with an intention of disposal*, which discusses the application of section CB 6 of the Income Tax Act 2007. Given the broad similarities of the tests in section CB 6 and CB 4, some of our comments on PUB00260 may also be relevant here. A copy of that submission is also attached.

Further information

Please do not hesitate to contact us, John Cantin on 04 816 4518, or Darshana Elwela on 09 367 5940, if you require further information on our submission.

Yours sincerely



John Cantin
Partner

Darshana Elwela
National Tax Director

EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY

Deadline for comment: 7 April 2016. Please quote reference: PUB00227.

QUESTION WE'VE BEEN ASKED QB XX/XX [KPMG comments]

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

An issue that Inland Revenue and taxpayers encounter from time to time is whether or when there will be tax consequences from the sale of gold bullion investments. It is sometimes suggested that because gold is often held as a long-term investment or hedge against inflation, there are no tax implications. However, others have taken the view that investments in gold will give rise to tax implications. For example, see: N Campbell and M McKay "Tax treatment of investments gone bad" (paper presented to New Zealand Institute of Chartered Accountants Tax Conference, Auckland, October 2010) and J Berry "Gold's glitter – going, going, gone?" (19 July 2013) NBR Weekend Review <http://www.nbr.co.nz/article/golds-glitter-%E2%80%93-going-going-gone-wb-143097>

This draft QWBA discusses the tax consequences of investing in gold bullion, so that taxpayers are aware of their obligations and the law is applied consistently.

All legislative references are to the Income Tax Act 2007 (the Act) unless otherwise stated.

This Question We've Been Asked is about s CB 4.

Question

1. If gold bullion is bought as an investment, do the proceeds from its sale need to be included as income for tax purposes?

Commented [JFC1]: Note it is possible that gold is not bought as an investment – see examples and comments regarding jewellery and collectables and also example. The QWBA also covers that situation.

Answer

2. Yes. The proceeds from the sale of gold bullion bought as an investment will be income for tax purposes.

3. Amounts derived on the disposal of personal property are income under s CB 4 if the property was acquired for the dominant purpose of disposal. Gold is personal property.

4. In the Commissioner's view, 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. The Commissioner considers that the very nature of the asset leads to the conclusion that it was acquired for the purpose of ultimately disposing of it. 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.

Commented [JFC2]: See comment above. Note also that it is possible that there may be a purpose which is not investment or "collectible". The QWBA should leave open that possibility.

5. The **reason** why a taxpayer decides to acquire property for disposal in due course is not relevant. That gold bullion may be described as an investment, or acquired to provide a hedge, does not suggest that it was not acquired for the purpose of disposal. Indeed, gold only has value as an investment or hedge because it will ultimately be disposed of. This can be contrasted with other investments, such as shares, that may be acquired for purposes other than their ultimate disposal. For example, shares may be acquired for a dividend stream or, even if the shares provide no yield, for any voting rights they confer.

6. Where gold is acquired for the purpose of disposal it is "revenue account property" and a deduction for the cost of the property is allowed, provided that the general permission is satisfied (see from [23]). The deduction is allocated to the earlier of the income year in which the property is disposed of or ceases to exist. So typically, a taxpayer can claim a deduction for the cost of the gold in the year they sell it. If the gold has gone down in value, and is sold for less than it cost, that would result in a deductible loss.

7. The principles discussed, and conclusions reached, in this "Question we've been asked" in relation to gold apply equally to sales of other precious metals purchased in bullion form.

Commented [JFC3]: This may be technically what section DB 23 says but see KPMG's s CB 6 submission (PUB00260). By definition, the general permission should be satisfied.

Explanation

What is the relevant taxing provision?

8. Section CB 4 provides that:

> **CB 4 Personal property acquired for purpose of disposal**
>
> An amount that a person derives from disposing of personal property is income of the person if they acquired the property for the purpose of disposing of it.

9. Amounts derived on the disposal of gold will therefore be income under s CB 4 if the gold was acquired for the purpose of disposal.

10. The leading case on s CB 4 is *CIR v National Distributors Ltd* (1989) 11 NZTC 6,346 (CA). This was a case about whether various parcels of shares were acquired for the purpose of selling or otherwise disposing of them, so that the proceeds on the sales would be taxable under what is now s CB 4. In discussing the provision, Richardson J noted that:

> Section 65(2) [now s CB 4] is expressed as a deeming provision. The assessable income of the taxpayer is deemed to include profits derived from transactions coming within the respective limb of para (e). The second limb has been in the legislation since 1916. **It brings within the tax net particular transactions which might otherwise escape liability. It does not perpetuate the theoretical distinction between capital and income. It is not to be read down by any preconceptions as to the nature of a tax on income or by importing a requirement that the acquisitions to which it refers should have a business overlay**. The words used must be given their natural and ordinary meaning (see *Lowe v Commissioner of Inland Revenue* [1981] 1 NZLR 326, 342).
>
> [Emphasis added]

11. The main principles on the application of s CB 4 that can be drawn from *National Distributors* are as follows:

- There is no business overlay to s CB 4; the distinction between capital and revenue is not relevant.
- All that is required is that the property be acquired **for the dominant purpose of disposal**.
- The onus is on the taxpayer to show that they did not acquire the property with the dominant purpose of disposal.
- The test of purpose is subjective, but the taxpayer's assertions as to their purpose need to be assessed against the totality of the circumstances. These will include the nature of the asset, the vocation of the taxpayer, the circumstances of the purchase, the number of similar transactions, the length of time the property was held, and the circumstances of the use and disposal of the asset.
- **It is important to bear in mind the distinction between motive and purpose; the reason why the taxpayer decided to acquire property with a view to disposal in due course is not relevant** to the statutory

inquiry. If the taxpayer's dominant purpose in acquiring the property is to dispose of it in the future, the provision will apply.

- If the taxpayer can establish that they had no clear purpose in mind when acquiring an asset, s CB 4 will not apply.

Overseas cases considering the taxation of gains on disposal of commodities

12. There are a number of overseas cases that have considered whether the sale of non-income producing assets gave rise to income – see for example: *CIR v Fraser* (1940-1942) 24 TC 498 (Scot CS (1 Div)), *Wisdom v Chamberlain (Inspector of Taxes)* [1969] 1 All ER 332 (CA), *Case Q109* 83 ATC 560 (Board of Review), *Victor Harms v MNR* 84 DTC 1666 (TCC), *Southco Holdings and Management Ltd et al v MNR* 75 DTC 162 (Tax Review Board), *Rutledge v CIR* (1928-1929) 14 TC 490 (Scot CS (1 Div)) and *Case 91* 25 CTBR (NS).

13. However, those cases considered provisions that were different to s CB 4. The issue in those cases was whether the transaction in question was an "adventure in the nature of trade", which would mean that the proceeds were income according to ordinary concepts rather than capital gains. One of the cases also considered whether the asset was acquired for the purpose of profit-making by sale, or as part of a profit-making undertaking or scheme.

14. None of the cases considered a provision akin to s CB 4. Section CB 4 requires only that the property was acquired for the purpose of disposal; it is not concerned with whether the amount derived is income according to ordinary concepts, and there does not need to be a purpose of profit-making by sale.

Will amounts derived on the disposal of gold bullion necessarily be income?

15. While the test of purpose for s CB 4 is subjective, as noted above, any assertion that property was not acquired for the purpose of disposal needs to be assessed against the totality of the circumstances. These include the nature of the asset, the vocation of the taxpayer, the circumstances of the purchase, the number of similar transactions, the length of time the property was held, and the circumstances of the use and disposal of the asset.

16. Gold bullion (bars or coins) is gold in bulk form, which is valued by its purity and mass as opposed to its face value. 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.

What if the gold was purchased as a hedge against inflation?

17. In *Wisdom v Chamberlain*, the fact that silver was acquired as a hedge against devaluation did not prevent the transactions being considered to be in the nature of trade. Similarly, in applying s CB 4, the distinction between motive and purpose must be borne in mind. The reason why a taxpayer decides to acquire property with a view to disposal in due course is not relevant to the application of s CB 4. That gold bullion may be described as an investment, or acquired to provide a hedge, does not suggest that it was not acquired for the purpose of disposal. Indeed, gold bullion only has value as an investment or hedge because it will ultimately be disposed of.

18. This can be contrasted with other investments, such as shares, that may be acquired for purposes other than their ultimate disposal. For example, shares may be acquired for a dividend stream or, even if the shares provide no yield, for any voting rights they confer.

Commented [JFC4]: Paragraph 12 and following says that this case, amongst others, is not relevant. Further, as a "in the nature of trade" inquiry, purpose and motive appear less relevant than the actual activity carried on. It does not appear to be relevant or supportive of the point being made.

What about gold jewellery and collectables, etc?

19. Where gold is purchased in the form of jewellery, antiques, ornaments, collectables or the like, it is arguable that, while the taxpayer may have in mind that the item could be disposed of in the future, the item gives rise to aesthetic enjoyment and pride of possession while held – at least if it is in the taxpayer's possession. As such, a taxpayer may (presuming they are in possession of the item) be able to show that the property was not acquired for the dominant purpose of disposal. Therefore, the disposal of such property may not give rise to income under s CB 4. However, in assessing whether the taxpayer acquired the property for the dominant purpose of disposal, the totality of the circumstances must be considered. These include: the nature of the asset, the taxpayer's occupation, the circumstances of the purchase, the number of similar transactions, the length of time the property was held, and the circumstances of the use and disposal of the asset.

What if a taxpayer has no purpose in purchasing the gold?

20. As noted above, if the taxpayer can establish that they had no clear purpose in mind when acquiring an asset, s CB 4 will not apply (*National Distributors*). The Commissioner considers it unlikely that a taxpayer could satisfactorily show that they purchased gold bullion with no clear purpose in mind.

What if the gold was purchased as part of a business?

21. Section CB 4 would not be relevant where a taxpayer sells or exchanges gold bullion in the ordinary course of their business, or has the bullion for use in producing stock for sale or exchange (for example, a jeweller who converts gold bullion into other forms for sale). In those situations, the commodity would be the taxpayer's "trading stock" (s EB 2). Business income is taxed under s CB 1, and the timing of deductions for the value of trading stock is determined under the trading stock rules (see in particular s DB 49(2)).

What deductions can be claimed?

22. Property that, if disposed of for valuable consideration, would produce income for a person is generally[1] "revenue account property" (as defined in s YA 1). Personal property that is acquired for the purpose of disposal is therefore revenue account property.

Commented [JFC5]: Para 22 and 23 should follow 11 as they are statements of principle of the relevant taxing provision. Para 24 can then be a "clean statement" that those principles are satisfied.

23. Section DB 23 permits a deduction for the cost of revenue account property. This is subject to the "general permission" (s DA 1) being satisfied. The general permission requires a nexus between the expenditure and the derivation of assessable and/or excluded income, or for the expenditure to have been incurred in the course of the person carrying on a business for the purpose of deriving assessable and/or excluded income.

24. Where gold bullion is revenue account property (which will typically be the case), s DB 23 will allow a deduction for the cost of the gold. The deduction is allocated to the earlier of the income year in which the gold is disposed of or ceases to exist (s EA 2). If the gold has gone down in value, and is sold for less than it cost, that would result in a deductible loss.

25. Where gold bullion is acquired for the purpose of being disposed of, the taxpayer would also be able to deduct expenditure such as interest on money borrowed to purchase the gold, insurance, storage costs, etc, (ss DA 1, DB 6, DB 7).

[1] The exceptions to this are not relevant for present purposes.

26. As noted above, where gold bullion is a taxpayer's trading stock, the timing of deductions for the value of the trading stock is determined under the trading stock rules (see in particular s DB 49(2)).

Examples

27. The following examples are included to assist in explaining the application of the law.

Example 1 – Purpose of ultimate disposal

28. Between late 2007 and early 2008, Zoë, who lives in New Zealand, purchased gold and silver units issued by an Australian mint. The units gave rise to ownership of a total of 57.986 ounces of gold (purchased for a total of NZD59,585.25) and 879.098 ounces of silver (purchased for a total of NZD18,606.99). Zoë was concerned about volatility in the share market, the economic uncertainty at the time, and the safety of the banking system. She considered that gold and silver provided a stable and low-risk investment option. Zoë did not have any particular timeframe in mind for holding the gold and silver units, as it depended in part on what happened with the equities and commodities markets.

29. Zoë sold the gold units in mid-2015 to help fund the purchase of a larger residential property. Those units were sold for NZD100,354.05. Zoë sold the silver units later in 2015 to fund her wedding. Those units were sold for NZD20,632.43.

30. Amounts derived on the disposal of personal property are income under s CB 4 if the property was acquired for the purpose of disposal. The Commissioner considers that the amounts derived on the sales of the gold and silver units are income under s CB 4, because those units were acquired for the purpose of ultimately being disposed of. The very nature of the asset leads to this conclusion. The units did not provide annual returns or income while being held and had use or value only in the ability to sell them in the future. The reason why a taxpayer decides to acquire property with a view to disposal in due course is not relevant to the application of s CB 4. The fact that the units were acquired as a stable investment does not suggest that they were not acquired for the purpose of disposal. The units only had value as an investment because they would ultimately be disposed of. The events that prompted Zoë to sell the units are not relevant to the application of s CB 4.

31. Under s CB 4, the amounts derived on the sales of the gold units (NZD100,354.05) and silver units (NZD20,632.43) are therefore income to Zoë in the 2015-2016 income year. Because the gold and silver units are revenue account property, and there is the necessary nexus between the expenditure incurred in purchasing the units and the derivation of income, Zoë is able to deduct the cost of that property under s DB 23. Zoë can therefore deduct NZD59,585.25 (the cost of the gold units) and NZD18,606.99 (the cost of the silver units) in the 2015-2016 income year.

Commented [JFC6]: Per s EA 2(2)

Example 2 – Personal use or enjoyment of asset and no history of similar transactions

32. In 2010, Neil purchased a Doctor Who themed coin set featuring twelve half-ounce silver coins presented in a fob watch case. The set cost $769. Neil purchased the set to add to his collection of limited edition coins and other television and movie memorabilia. The mintage is sold out, and Neil wants to know whether, if he sold the set, the amount derived on the sale would be income. Neil has not previously sold any of his collectable coins or memorabilia, but an acquaintance of his, an ardent Doctor Who fan, has indicated that he is

keen to buy the set, and is prepared to pay $1,200 for it. Since 2010, Neil's financial situation has changed, so the offer is appealing.

33. Amounts derived on the disposal of personal property are income under s CB 4 if the property was acquired for the purpose of disposal. In these circumstances, the Commissioner would accept that Neil did not acquire the coin set for the purpose of disposal. Neil purchased the coin set to add to his collection, for his personal enjoyment. He does not have a history of selling his coins or other memorabilia, and he is only contemplating the sale to his acquaintance because of his current financial situation.

34. There would therefore be no income arising to Neil under s CB 4 in the event that he proceeds with the sale.

Draft items produced by the Office of the Chief Tax Counsel represent the preliminary, though considered, views of the Commissioner of Inland Revenue.

In draft form these items may not be relied on by taxation officers, taxpayers, and practitioners. Only finalised items represent authoritative statements by Inland Revenue of its stance on the particular issues covered.

References

Subject references

Income tax, revenue account property, property acquired for the purpose of disposal, non-income producing commodities, gold, precious metals

Legislative references

Income Tax Act 2007 – ss CB 4, DA 1, DB 6, DB 7, DB 23, DB 49(2), EA 2, EB 2, FB 1, FB 2, FC 1, FC 2, FC 3, FC 4 and the definition of "revenue account property" in s YA 1

Case references

Case 91 25 CTBR (NS)
Case Q109 83 ATC 560 (Board of Review)
CIR v Fraser (1940-1942) 24 TC 498 (Scot CS (1 Div))
CIR v National Distributors Ltd (1989) 11 NZTC 6,346 (CA)
Rutledge v CIR (1928-1929) 14 TC 490 (Scot CS (1 Div))
Southco Holdings and Management Ltd et al v MNR 75 DTC 162 (Tax Review Board)
Victor Harms v MNR 84 DTC 1666 (TCC)
Wisdom v Chamberlain (Inspector of Taxes) [1969] 1 All ER 332 (CA)

Copy of KPMG submission on PUB00260

KPMG
10 Customhouse Quay
P.O. Box 996
Wellington
New Zealand

Telephone +64 (4) 816 4500
Fax +64 (4) 816 4600
Internet www.kpmg.com/nz

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

Our ref 160408KPMGSubCB6

8 April 2016

Dear Sir or Madam

KPMG Submission - PUB00260: Land acquired for a purpose or with an intention of disposal

KPMG is pleased to make a submission on the above draft Question We've Been Asked ("QWBA") item.

Need for greater taxpayer education

We consider that guidance on the application of the intention test for land (section CB 6) is timely, particularly with the introduction of the new bright-line rule (section CB 6A) from 1 October 2015.

In KPMG's experience from educating taxpayers and various participants in the land transfer process on the application of the bright-line rule, there appears to be a general lack of understanding of how proceeds from the sale of land could be taxable under other rules, including section CB 6.

Therefore, to have maximum impact, we believe the finalised QWBA needs to be widely circulated to the general public. This means using communication channels beyond those employed normally for Commissioner's statements, such as Tax Information Bulletins.

For example, the QWBA content should be included in the IR 264 rental income guide, which already includes a section on the bright-line rule. The item should also receive prominent coverage on Inland Revenue's website, once published.

Consolidating the various Inland Revenue guidance on the land sale rules

The Commissioner should also take the opportunity to consolidate the various guidance released on the application of the land sale rules.

We note that some of the more recent guidance released by Inland Revenue on different aspects of the land sale rules includes:

- QB 15/13: Whether the cost of acquiring an option to acquire revenue account land is deductible.
- QB 15/04: Whether it is possible that the disposal of land that is part of an undertaking or scheme involving development or division will not give rise to income, even if no exclusion applies.
- QB 15/02: Major development or division – what is "significant expenditure" for section CB 13 purposes?
- Tax Information Bulletin ("TIB") item on "Clarifying the acquisition date of land" in section CB 15B. (We note that this is not a Commissioner's Statement, however, the TIB is an important statement of how new section CB 15B is intended to operate.)

One of the challenges for taxpayers is determining whether the Commissioner has a view on a particular aspect of the land sale rules. The current process requires a search of Inland Revenue's website, which is not the most user-friendly, and knowledge of the appropriate terminology. Alternatively, taxpayers need to seek specialist advice at cost.

We believe that the Commissioner's guidance should be consolidated, if not in a single document, then at least on a single page on the Department's website to make navigation and search easier.

Our detailed submissions

We broadly agree with the conclusions of the draft QWBA. Our comments are in relation to the following specific issues. We have also attached a marked-up version of the QWBA to highlight how some of our submissions below can be implemented.

Application of the residential land exclusion (section CB 16)

Paragraph 5 of the draft QWBA outlines the two key exclusions from section CB 6, the residential land and business premises exemptions.

In relation to the former, there is little analysis on when a property that would otherwise be subject to section CB 6 would not be taxable because it qualifies as residential land. In particular, there is no discussion of what "occupied mainly as a residence" by a person and any member of their family means.

We note that uncertainty arose under the "main home" exemption, in section CB 16A, which is worded differently to the residential land exclusion. (We note that this was once of the concerns submitters, including KPMG, raised.)

For the main home exemption rule in section CB 16A to apply, the land must be (i) used predominantly as a person's main home; and (ii) used for most of the time as their main home.

In the Special Report on the bright-line rule, Officials indicated that it (i) should be calculated by reference to the area of land used for residential and non-residential purposes and (ii) requires the property to have been used more than 50% of the time as a main home. (While the

Special Report does not carry legislative weight, at a minimum it at least clarifies the stated legislative intent of section CB 16A.)

Our concern is the Commissioner applying the interpretation in the Special Report to also determine whether land is occupied mainly as a residence, for section CB 16 purposes. It should be explicitly clarified in the QWBA that this will not be the case as these are different legislative exemptions. If Parliament had intended for the same exclusion to apply, then it would have subjected section CB 6A to section CB 16, instead of including new section CB 16A.

For optimum clarity, however, the Commissioner should outline in the QWBA what factors she will consider when determining whether section CB 16 is applicable.

Definition of "land"

Paragraph 19 notes that "land" could include any estate or interest in land (including an option). Importantly, the land sale rules will also apply to leasehold interests and equitable interests in land. However, the draft QWBA does not expand on the potential impacts of the land sales rules applying.

This appears to be an area which is often overlooked, including by the Commissioner when providing draft guidance. KPMG noted in its submission on the Taxation (Bright-line Test for Residential Land) Bill our concern with the potential application of the bright-line rule on expiry of leasehold interests. The Official's Report response was that this would not be a disposal, for tax purposes, even though this is, to us, the logical outcome when applying the analysis in QB 15/13 on expiry of an option over land. This highlights to us the potential difficulties in interpretation in this area, and the scope to take a different view to the Commissioner.

Misstatement of the application of bright-line test (and other land sale rules)

We have concerns with how discussion of the bright-line rule has been incorporated in the draft QWBA.

The technical application (or non-application) of that rule is misstated in the main analysis and the Examples. The bright-line rule (in section CB 6A) only applies if sections CB 6 to CB 12 do not apply. Consideration therefore needs to be given to the "other" land sale rules first.

This is not necessarily the same as saying that, if the bright-line test is not applicable, the other land sale rules may apply (in paragraph 7), or that the other land sale rules (e.g. section CB 6) need not be considered if the bright-line test applies (in paragraph 28), which is technically wrong as those rules must be considered first.

We acknowledge that practically the same outcome may arise. However, stating the correct approach is important, particularly for applying the Residential Land Withholding Tax, once those rules are enacted.

Paragraph 26 states that the Examples do not consider whether any of the other land sales rules apply. In fact, the Examples do consider the application of section CB 6A.

In our mark-up, we have removed unnecessary references to section CB 6A in the QWBA to simplify the analysis and the Examples.

Deductibility of costs

Paragraph 21 of the draft QWBA states that a deduction for the cost of land, capital improvements, and other holding costs (e.g. interest, insurance, repairs and maintenance) is subject to meeting the requirements of sections DA 1, DA 2, DB 6 and DB 23.

If the gain from the sale of land is taxable under section CB 6, then the general permission (in section DA 1) should be met, and neither the capital limitation, private limitation nor any other general limitations (in section DA 2) should be applicable to limit the deductibility of costs.

This is because:

- The application of section CB 6 to the sales proceeds provides sufficient nexus with derivation of assessable income, such that the general permission is satisfied;
- The capital limitation is not applicable as the gain will be of a revenue nature (again due to the application of section CB 6 to the proceeds);
- The private limitation is not applicable as the gain will not be of a private or domestic nature (i.e. the residential land exclusion in section CB 16 will not be applicable); and
- The interest deductibility (section DB 6) and deduction for cost of revenue account property (section DB 23) provisions override the capital limitation (and as noted above, the general permission will be met).

This should be made explicit in the draft QWBA. Again, we have attempted to clarify this in our mark-up of the QWBA.

Similarly, the Examples confirm the deductibility of costs of any repairs and maintenance on the properties that are not capital in nature. We cannot see how repairs and maintenance can be capital in nature. If properly characterised as repairs, the expenditure is not capital in nature and would be deductible. If capital, then the repairs would be properly characterised as improvements. A deduction would be allowed under section DB 23. We have made some deletions to the QWBA to reflect this.

We acknowledge that this may be a drafting issue – intended to convey that the capital limitation applies to unspecified expenditure. If that is the case, this should be separated from the items which are not capital in nature.

Examples in the draft QWBA

We support the inclusion of examples in the draft QWBA. However, our concern is that they are too stylized (in particular Examples 3, 4 and 5) to generate a conclusion that is largely beyond argument.

The fact patterns of some of the Examples are too convoluted and crowded. By way of illustration, Example 3, where Taj acquires 28 properties, sells 23 of the properties and within

six months of each sale buys a new replacement property. We assume the main point of this example is to illustrate that the stated reasons for disposal do not stack up. However, this point can still be made with a much simpler fact pattern. A consequence of the fact pattern is the conclusion that all of the properties are similarly tainted. It may well be, objectively, that some properties, acquired for rental purposes were genuinely sold due to unsolicited offers to purchase and/or financial difficulties (which as noted under Example 1 is an appropriate defence against the application of section CB 6). This demonstrates the dangers of a "kitchen sink" analysis, rather than evaluating the facts and circumstances of each transaction separately.

In the case of Example 5, it is unclear what impact (if any) the marketing of the potential capital growth of an investment property would have on whether section CB 6 applies, as compared to Chris having a fixed investment horizon of 3 to 5 years for the property. It seems to us that the latter is the critical reason for the revenue account conclusion in that Example. This should be clarified in the QWBA. Most marketing materials for investment properties, particularly in the current housing market, will emphasise potential capital returns. This, in and of itself, should not be used as a proxy for intention of resale, if the property is subsequently sold.

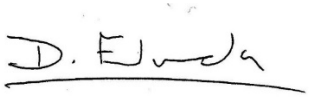
We also consider that it is important that it is Chris (and not the marketing agent) who has an expectation of capital growth. We acknowledge that objective evidence may however be difficult to find.

Similar to concerns we have raised previously in relation to other published QWBAs and Commissioner's Statements, the Examples are not helpful in providing guidance on the difficult boundary issues taxpayers may face. They are therefore limited in their illustrative value.

Further information

Please do not hesitate to contact us, John Cantin on 04 816 4518, or Darshana Elwela on 09 367 5940, if you require further information on our submission.

Yours sincerely



John Cantin
Partner

Darshana Elwela
National Tax Director

EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY

Deadline for comment: 7 April 2016. Please quote reference: PUB00260.

QUESTION WE'VE BEEN ASKED QB XX/XX [KPMG suggested drafting changes]

INCOME TAX – LAND ACQUIRED FOR A PURPOSE OR WITH AN INTENTION OF DISPOSAL

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Question We've Been Asked is about s CB 6.

Question

1. When will the proceeds of the sale of land need to be included as income for tax purposes, under s CB 6?

Answer

2. If you buy land for a purpose or with an intention of selling it, the proceeds of the eventual sale, whenever that occurs, will be income under s CB 6 unless one of the exclusions from that rule (for residential land and business premises) applies.

Explanation

What is the relevant taxing provision?

3. Section CB 6(1) provides that:

> **CB 6 Disposal: land acquired for purpose or with intention of disposal**
>
> *Income*
>
> (1) An amount that a person derives from disposing of land is income of the person if they acquired the land—
>
> (a) for 1 or more purposes that included the purpose of disposing of it:
>
> (b) with 1 or more intentions that included the intention of disposing of it.

4. An amount that you derive on the disposal of land will therefore be income under s CB 6 if you acquired the land for a purpose or with an intention of disposing of it. Disposal does not have to be your dominant purpose.

5. There are two exclusions from this. Even if you acquired the land for a purpose or with an intention of disposing of it, you **will not be taxed** on the proceeds of the sale if one of these exclusions applies:

Exclusion 1 – Residential land (s CB 16)

If the land has a house on it, or you build one, and you occupy the house mainly as a residence, you will not be taxed on the proceeds from selling the property. This also applies if you are trustee of a trust, and a beneficiary of the trust occupies the house mainly as a residence.

Please note that you cannot use this exclusion if you have a regular pattern of acquiring and disposing of houses, or building and disposing of houses.

Exclusion 2 – Business premises (s CB 19)

If the land is the premises of a business, and you acquired and occupied the premises or built and occupied the premises mainly to carry on a substantial business from them, you will not be taxed on the proceeds from selling the property.

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Please note that you cannot use this exclusion if you have a regular pattern of acquiring and disposing of, or building and disposing of, premises for businesses.

How does the purpose or intention rule relate to the 2-year "bright-line" rule?

6. The new 2-year "bright-line" rule (s CB 6A) taxes any gains from residential property that is disposed of within two years of being acquired.

7. The 2-year "bright-line" rule is **in addition** to the other land sale rules that have been in New Zealand's tax law for many years. If the proceeds from selling land are taxed under one of the other land sale rules, including the purpose or intention rule, s CB 6A is not applicable.

When will the proceeds of a land sale be income under s CB 6?

8. As noted above, an amount that you derive on the disposal of land will be income under s CB 6 if you acquired the land for a purpose or with an intention of disposing of it. But remember that there are exclusions for residential land and business premises that might apply (see [5]).

9. The key things to bear in mind in deciding if s CB 6 applies are:

- What matters is your purpose or intention **when you acquired** the land.
- A purpose or intention of disposing of the land does not need to be the only purpose or intention you had when you acquired the land. It also does not need to be your dominant or main purpose or intention. It is enough if disposal is one of your purposes or intentions.
- Disposing of the land has to be more than a vague idea or just a possibility or option in the future. You have to have a firm purpose or intention of disposing of the land.
- The test of whether you had a purpose or intention of disposing of the land is subjective. But what you say your purpose or intention was will be assessed against all of the circumstances.
- Evidence of what your purpose or intention was before you acquired the land (eg, during the whole acquisition process) can be taken into account.
- The extent of commitments you make or steps you take shortly after you acquired the land may be relevant in testing what your subjective purpose or intention was.
- The length of time you held the land may also be taken into account, and if you have a pattern of acquiring and disposing of land within relatively short timeframes, that is likely to be relevant.
- The onus is on you to show that you did not acquire the land for a purpose or with an intention of disposing of it.

(See for example: *CIR v Boanas* (2008) 23 NZTC 22,046 (HC), *Case N59* (1991) 13 NZTC 3,457, *Harkness v CIR* (1975) 2 NZTC 61,017 (SC), *Anzamco Ltd (in liq) v CIR* (1983) 6 NZTC 61,522 (HC), *Case Y3* (2007) 23 NZTC 13,028 and *Jurgens & Doyle v CIR* (1990) 12 NZTC 7,074 (HC)).

When do you test what my intention was?

10. It is your purpose or intention when you **acquired** the land that is relevant.

11. Land is normally acquired for s CB 6 purposes on the date you enter into a binding sale and purchase agreement to buy the land (even if this is subject to conditions, eg, finance, or obtaining a satisfactory LIM or building report). The

Deleted: There are special rules about when you are treated as acquiring the land for the "bright-line" rule. In a typical land purchase situation, this will be when the title is registered to you. There are some exclusions from the 2-year "bright-line" rule, including an exclusion for your main home.

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time of acquisition may be different in particular circumstances, for example, if you acquired the land through exercising an option (see s CB 15B).[1]

What if I did not have any firm intention when I bought the land?

12. If at the time you acquired the land you did not have a firm purpose or intention, you will not have a purpose or intention of disposal. You will not be taxed on the proceeds of its eventual sale under s CB 6.

13. However, if the Commissioner questions whether you acquired the land with a purpose or intention of disposal, remember that the onus is on you to show that you did not. What you say your purpose or intention was will be assessed against all of the circumstances.

What if my intention changes and I decide not to sell the land?

14. The only thing that is relevant is your purpose or intention when you **acquired** the land. If you acquired the land with a purpose or intention of disposing of it, but change your mind and decide to do something else (eg, rent the property out), you will still be taxed on the proceeds if you eventually sell it.

What if I own the land for more than 10 years before I sell it?

15. A common misconception is that if you hold the land for more than 10 years you will not be taxed on the sale proceeds. This is not true. If you acquired the land with a purpose or intention of disposal, s CB 6 will apply to tax the proceeds **whenever** you eventually sell the land (subject to the exclusions noted at [5]).

What if I have rented out the property and paid tax on the rental income?

16. If you acquired the land with a purpose or intention of disposing of it, but change your mind and decide to rent the property out instead, you will still be taxed on the proceeds when you eventually sell it. This is the case even though the rental income will have been subject to tax. The rental income and the proceeds on the sale are both taxed under the Act (see s CC 1).

What if I only sell some of the land?

17. It does not matter if you divide the land and sell only some of it at any one time – you will still be taxed on the proceeds of all of the land whenever it is sold. Similarly, it does not matter if you sell the land you acquired together with some other land. The proceeds on the sale of the original piece of land you acquired with a purpose or intention of disposal will be taxed under s CB 6 irrespective of what you subsequently do with the land or its boundaries (see ss CB 6(3) and CB 23B).

What if a trust or company buys the property?

18. Section CB 6 can apply regardless of whether the property is acquired by an individual person or an entity such as a trust or company. If the owner is a trust or company, it is generally the purposes or intentions of the trustees or directors that are relevant in deciding if s CB 6 applies.

Does this only apply to sales of freehold land?

19. No. "Land" is defined in the Act as including any estate or interest in land, and as including an option to acquire land or an estate or interest in land. You could be taxed under s CB 6 if you dispose of any land interest, not just the freehold estate. For example, you could be taxed if you dispose of a leasehold, unit title

[1] Note that these rules about when land is acquired apply for disposals of land on or after 22 November 2013. See Tax Information Bulletin Vol 26, No 7, August 2014.

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or cross-lease interest, an option to acquire land, or an equitable interest in land (eg, by transferring the right to acquire land under a sale and purchase agreement to someone else).

Can I gift the land instead so I do not have to pay tax?

20. No. Property cannot be gifted to get around paying tax on its sale. The Act would treat a gift of land you acquired with a purpose or intention of disposal as being made at market value. You would be subject to tax on that amount, less any allowable deductions (see ss FC 1 and FC 2).

Can I get any tax deductions?

21. Yes. If s CB 6 taxes you on the proceeds of selling land, you will get a deduction for the cost of the land and any capital improvements you make to it, as those costs are incurred in deriving the income under s CB 6 and are not private in nature (ss DB 23, DA 1 and DA 2(2)). The deduction is taken in the income year in which you dispose of the land (see s EA 2).

22. You will also be able to deduct other expenditure, such as interest on money borrowed to purchase the land, insurance, and repairs and maintenance. Deductions for these expenses will be allowed as they are incurred in deriving the income under s CB 6 and are not private in nature (ss DA 1, DA 2 and DB 6).

Other taxing provisions that could apply if s CB 6 doesn't

23. As well as the 2-year "bright-line" rule (see from [6]) and s CB 6 (see from [8]), there are a number of other land sale rules in the Act that might tax you on the sale proceeds. For example, you might be taxed on the proceeds of selling land if:

- you acquired the land for the purpose of a business (carried on by you or by an associated person) of dealing in land, developing land, dividing land into lots, or erecting buildings (s CB 7);
- you dispose of the land within 10 years of acquiring it, if at the time you acquired it you were (or were associated with someone who was) in the business of dealing in land, or developing or dividing land (ss CB 9 and CB 10);
- you dispose of the land within 10 years of completing improvements to it, if at the time you acquired it you were (or were associated with someone who was) in the business of erecting buildings (s CB 11); or
- the land was part of an undertaking or scheme, meeting certain criteria, that involved the development of land or the division of land into lots (ss CB 12 and CB 13).

24. There are exclusions from each of these rules that might be relevant to you.

What if I have possibly taken an incorrect tax position for past property sales?

25. If you think you may have taken a tax position for property sales in past tax years that is different from the Commissioner's position on how these provisions apply, we suggest you discuss the matter with your tax advisor, or us, and consider making a voluntary disclosure.

Examples

26. The following examples are included to assist in explaining the application of the law. The examples do not consider the criteria for the exclusions to s CB 6 in any great detail, as they clearly do not apply in any of the circumstances considered. Importantly, the examples do not consider whether any of the other land sale

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rules in the Act apply. If they did apply in any of the Examples, taxable income would arise.

Example 1 – Change of purpose or intention between contract and settlement

27. On 10 September 2015, Tabitha and Jono entered into a sale and purchase agreement to buy a house for $2m. They planned to move into the house with their three children. On 21 September 2015, before settlement of the purchase, Tabitha and Jono were approached with an unsolicited offer to purchase the property for $2.25m. Tabitha and Jono decided that this offer was too attractive to turn down, confident they could find another equally desirable family home for that amount. Tabitha and Jono therefore accepted the offer on 23 September 2015, entering into a sale and purchase agreement to sell the house. Tabitha and Jono's purchase of the property was settled on 25 September 2015, and their sale of the property was settled the following week.

29. The proceeds on the sale are therefore not income to Tabitha and Jono under s CB 6.

Example 2 – Change of purpose or intention after acquisition, and property held for over 10 years

30. On 11 October 2005, Laura and Connor entered into a sale and purchase agreement to purchase a property that they intended to renovate and on-sell. They advised their bank of this, as they needed to borrow sufficient funds to pay for the renovations. The purchase of the property was settled on 30 October 2005, and Laura and Connor started the renovations. After the renovation work was complete, Laura and Connor decided not to sell the property at that time, but to rent it out instead. Laura and Connor have paid tax on the rental income. In 2015, Laura and Connor decided to sell the property, and they did so on 4 December 2015.

31. For the purposes of s CB 6, Laura and Connor acquired the land on 11 October 2005, when they entered into the sale and purchase agreement to buy the property. At that time, their intention was to renovate the house and sell it. It does not matter that Laura and Connor subsequently changed their minds and decided to rent the property out instead of selling it. At the date they acquired the property, their purpose or intention was to dispose of it.

32. Neither the residential exclusion (s CB 16) nor the business exclusion (s CB 19) apply, because Laura and Connor did not live in the property or carry on a business from it.

33. The proceeds on the sale of the property are therefore income to Laura and Connor under s CB 6.

34. It is not relevant that the rental income was subject to tax – the Act taxes rental income as well as the proceeds on the sale of the property.

35. It is not relevant that Laura and Connor held the property for more than 10 years before selling it. If land is acquired with a purpose or intention of disposal, the proceeds will be taxed whenever the property is eventually sold.

36. Laura and Connor can get a deduction against the sale proceeds for the amount they paid to acquire the property and for the cost of any renovations that were capital in nature. In each year they owned the property, they will also have been allowed to deduct the interest on the money they borrowed to purchase the property and undertake the renovations, the cost of insurance on the property, and the cost of any repairs and maintenance on the property.

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Example 3 – Purpose or intention to be assessed against all of the circumstances

37. Taj acquired 28 properties over a 10-year period – all before 1 October 2015. Twenty-three of those properties have been sold to date. Taj considers that none of those sales give rise to income under s CB 6, stating that all of the properties were acquired for long-term rental. Taj states that the twenty-three properties in question were only sold due to financial pressure, the cost of servicing the mortgages, difficult tenants, or because of unsolicited offers to purchase the properties. Taj states that any renovation work done on the properties was for the purpose of deriving higher rental income.

38. However, all of the twenty-three properties were on-sold within relatively short periods after their acquisition, most of them after some renovation work. The average time the properties were held is approximately one year. Ten of the properties were held for less than six months. After each of the twenty-three properties was sold, a new property was purchased within an average of six months. Taj has only returned rental income from two of the properties.

39. The test of whether a taxpayer had a purpose or intention of disposing of land when they acquired it is subjective. However, a person's stated purpose or intention needs to be assessed against all of the circumstances.

40. In this case, Taj's explanations for the sales are not supported by the circumstances as a whole. None of the properties were held for long-term rental purposes, which is what Taj says they were acquired for. Indeed, rental income was only returned from two of the properties. The explanations for the sales are not supported by the evidence. The fact that new properties were purchased within an average of six months after each sale undermines Taj's assertion that the sales were due to financial pressure and the cost of servicing the mortgages. The pattern of purchases, renovation (in most cases) and relatively fast re-sale of the properties without them having been rented out (for the most part) indicates that Taj acquired the properties with a purpose or intention of disposing of them.

41. Neither the residential exclusion (s CB 16) nor the business exclusion (s CB 19) apply in respect of any of the properties, because Taj did not live in any of them or carry on a business from any of them.

42. Therefore, the Commissioner considers that the proceeds on the sales of the twenty-three properties in question are income to Taj under s CB 6.

43. Taj can get a deduction against the sale proceeds for the amounts he paid to acquire the properties and for the cost of any renovations that were capital in nature. Taj will also be allowed to deduct the interest on the money he borrowed to purchase the properties and undertake the renovations, the cost of insurance on the properties, and the cost of any repairs and maintenance on the properties.

Example 4 – Onus on the taxpayer to show that land not acquired with a purpose or intention of disposal

44. Hugh and Meg purchased five residential properties in 2014. They renovated the properties, and sold them in 2015 for a total profit of $2.2m. Hugh and Meg have stated that they have relatives overseas who had applied for New Zealand residency and who intended to live in the properties. Hugh and Meg assert that the properties were only sold in 2015 because the residency applications were unsuccessful. Hugh and Meg have not provided any evidence that any relatives overseas had applied for New Zealand residency and had those applications rejected.

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45. If the Commissioner questions whether you acquired the land with a purpose or intention of disposal, the onus is on you to show that you did not.

46. Hugh and Meg purchased five properties that they renovated and sold for a profit in a short space of time. They have not provided any evidence that any relatives overseas had applied for New Zealand residency and had those applications rejected. In these circumstances, the Commissioner is not satisfied that Hugh and Meg did not acquire the properties with a purpose or intention of disposal. There is no evidence to support their stated purpose of acquiring the properties as future homes for relatives seeking residency.

47. Neither the residential exclusion (s CB 16) nor the business exclusion (s CB 19) apply in respect of any of the properties, because Hugh and Meg did not live in any of them or carry on a business from any of them.

48. The Commissioner therefore considers that the proceeds on the sales of the properties are income to Hugh and Meg under s CB 6.

49. Hugh and Meg can get a deduction against the sale proceeds for the amounts they paid to acquire the properties and for the cost of any renovations that were capital in nature. They will also be allowed to deduct the interest on the money they borrowed to purchase the properties and undertake the renovations, the cost of insurance on the properties, and the cost of any repairs and maintenance on the properties.

Example 5 – More than one purpose or intention

50. Chris purchased a property in August 2012. The property was marketed as being an attractive investment – ideal as a rental property, and expected to have "great annual capital growth". Chris decided to buy the property to rent it out for three to five years, by which stage he hoped to be able to realise a capital gain on the property. Chris has paid tax on the rental income. He sold the property in October 2015 for a sizeable profit.

51. An amount that a person derives on the disposal of land will be income under s CB 6 if they acquired the land for a purpose or with an intention of disposing of it. A purpose or intention of disposing of the land does not need to be the **only** purpose or intention the person had when they acquired the land. It also does not need to be their dominant or main purpose or intention. It is enough if disposal is one of their purposes or intentions.

52. Chris invested in the property in question because he expected it to have great annual capital growth, and it could be rented out in the meantime. He purchased the property with the purpose of renting it out in the short-medium term (three to five years) and then selling it to realise the expected capital gain.

53. It does not matter that Chris acquired the property for more than one purpose, and disposal was only one of those purposes. When he acquired the property, Chris had a firm purpose of disposing of it in three to five years to hopefully make a capital gain.

54. Neither the residential exclusion (s CB 16) nor the business exclusion (s CB 19) apply in respect of the property, because Chris did not live in it or carry on a business from it.

55. The proceeds on the sale of the property are therefore income to Chris under s CB 6.

56. It is not relevant that the rental income was subject to tax – the Act taxes rental income as well as the proceeds on the sale of the property.

Deleted: <#>The 2-year "bright-line" rule does not apply to the sales of the properties in question, because they were all acquired before 1 October 2015. If Hugh and Meg had acquired any of the properties on or after 1 October 2015, the proceeds of the sales of those properties would be taxed under the 2-year "bright-line" if the sale was within two years of the property being acquired. It would not be necessary to consider s CB 6 for any sales taxed under the 2-year "bright-line" rule.¶

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57. Chris can get a deduction against the sale proceeds for the amount he paid to acquire the property and for any capital improvements he made to the property. In each year he owned the property he will also have been allowed to deduct the interest on the money he borrowed to purchase the property, the cost of insurance on the property, and the cost of any repairs and maintenance on the property.

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Draft items produced by the Office of the Chief Tax Counsel represent the preliminary, though considered, views of the Commissioner of Inland Revenue.

In draft form these items may not be relied on by taxation officers, taxpayers, and practitioners. Only finalised items represent authoritative statements by Inland Revenue of its stance on the particular issues covered.

References

Subject references
Income tax, sale of land, purpose or intention of disposal

Legislative references
Income Tax Act 2007 – ss CB 6A, CB 6, CB 7, CB 9, CB 10, CB 11, CB 12, CB 13, CB 15B, CB 16, CB 19, CB 23B, CC 1, DA 1, DB 6, DB 7, DB 23, EA 2, FC 1 and FC 2

Case references
Anzamco Ltd (in liq) v CIR (1983) 6 NZTC 61,522 (HC)
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