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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

Cabinet Economic Growth and Infrastructure Committee

Clarifying the acquisition date of land: an official's issues paper

Proposal

1. The officials' issues paper, *Clarifying the acquisition date of land*, is attached for the Committee's consideration. The issues paper seeks submissions on suggested legislative options to clarify section CB 6 of the Income Tax Act 2007, a provision that deals with land acquired for the intention or purpose of disposal. This is primarily an issue of legal interpretation, where a clarification of the law will help ensure that the right policy outcome is achieved.
2. Subject to Cabinet approval, I propose to release the issues paper for public consultation as part of the Budget 2013, in conjunction with the announcement of the continued funding of Inland Revenue's property compliance project. The feedback received from this consultative process will inform any final policy proposals, with final policy decisions to be sought from the Committee later this year.

Executive summary

3. A key element of an efficient tax system is certainty. That is, a person's liability for tax should be as clear and as certain as possible, especially in New Zealand where the tax system is based on self-assessment. The attached officials' issues paper focuses on the taxation of land disposal provisions in the Income Tax Act 2007, in particular section CB 6, which is causing considerable uncertainty for taxpayers, their agents and Inland Revenue.
4. Section CB 6 deals with land acquired for the purpose or with the intention of disposal, and the taxation of income derived from disposing of the land. If a taxpayer acquires the land with the intention or purpose of disposal and subsequently disposes of the land, any profit they make from the disposal is taxable.
5. This provision has been included in one form or another in New Zealand's tax legislation since the late 1800s. The policy is intended to capture property speculators who treat land as a revenue item (like trading stock) as opposed to a capital asset.
6. The uncertainty is caused by the timing of when the taxpayer's intention or purpose should be tested. The Courts have held that intention or purpose should be tested when a taxpayer has acquired the land in question (known as the date of acquisition). However, because the definition of "land" in the Income Tax Act 2007 includes estates and interests in land, and the taxpayer acquires different interests and estates in "land" during a typical sale and purchase agreement, which are then merged when the title is registered, neither the legislation nor common law have provided sufficient clarity on which interest in "land" the date of acquisition should apply to.

7. As a result, taxpayers may be unable to self-assess whether gains made from a disposal of land should be returned as taxable income. Often, taxpayers are made aware of a tax liability only as a result of an Inland Revenue audit. I consider that a suitable amendment will clarify the law, and result in greater certainty for taxpayers.

8. The issues paper suggests two possible options for a date of acquisition, based on events/phases of an agreement for the sale and purchase of land, either:

- the date the sale and purchase agreement is entered into; or
- the date when all the conditions of the agreement for the sale and purchase of “land” have been fulfilled.

9. The issues paper also seeks views on whether a legislative amendment is needed that allows for evidence presented before and after the date of acquisition to be considered when determining what the taxpayer’s intention was on the date of acquisition.

10. I seek Cabinet’s approval to release the issues paper for public consultation, with final policy decisions to be formed later in 2013. I propose that the issues paper be released as part of Budget 2013. The Government proposes, as part of Budget 2013, to continue funding Inland Revenue’s property compliance project. This issues paper, with its focus on clarifying how the tax rules apply to land transactions, should be announced in conjunction with the property compliance funding initiative.

11. I propose that there be a six-week submission period.

Background

12. Subpart CB of the Income Tax Act 2007 contains provisions that deal with the taxation of income from the disposal of land. In particular, section CB 6 deals with land acquired for the purpose of or with the intention of disposal, and the taxation of income derived from the disposing of the land. Therefore, if a taxpayer acquires the land with the intention or purpose of disposal and subsequently disposes of the land, any profit they make from the disposal is taxable.

13. The legislative history of section CB 6 is lengthy, as the profits made from the sale or disposition of real property were first considered to be a source of “business income” in the Land and Income Assessment Act 1891.

14. The policy intent of this section is to capture property speculators, who can be described as persons who buy and sell land with the intent or purpose of making a profit without necessarily developing or improving the land, and rely instead on chance, trend or volatility of the property market to provide financial gain.

15. The key distinction between section CB 6 and a general capital gains tax are the subjective elements, as the tax burden falls only on those who have the necessary intention or purpose to use land as if it were a trading asset. In this way, the section attempts to distinguish between those who hold land as a capital asset and those who hold it as a revenue item. The economic rationale for this is that if a person can make gains from buying and

selling land without being taxed on these gains, it would be inefficient for them to divert work effort away from taxable activities towards this task.

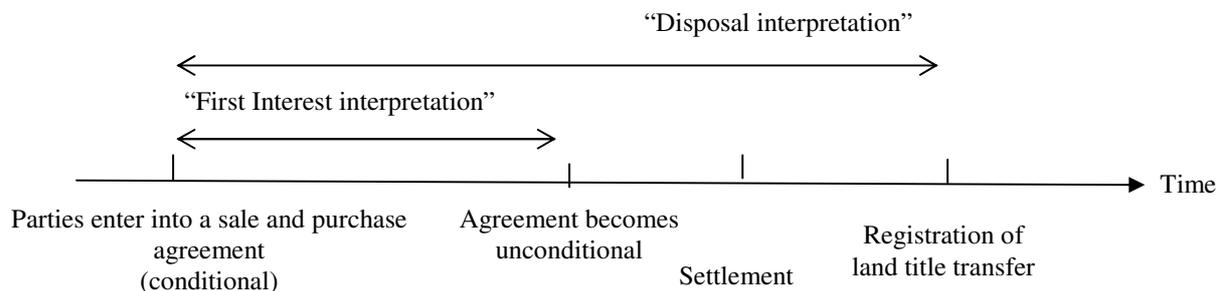
The problem: applying different dates of acquisition

16. The uncertainty the issues paper seeks to address is caused by the timing of when the taxpayer's intention or purpose should be tested. The Courts have held that intention or purpose should be tested when a taxpayer has acquired the land in question (known as the date of acquisition). However, because the definition of "land" in the Income Tax Act 2007 includes estates and interests in land, and the taxpayer acquires different interests and estates in "land" during a typical sale and purchase agreement which are then merged when the title is registered, neither the legislation nor common law have provided sufficient clarity on which "land" the date of acquisition should apply to.

17. There are two reasonable interpretations. The first is that the date of acquisition is the date when the first interest (equitable or legal) in land arises under an agreement for the sale and purchase of land (the "first interest" interpretation). The date of acquisition would therefore fall in one of the initial phases of a sale and purchase agreement, either:

- the date the agreement was entered into (even if the agreement was still conditional); or
- the date when all the conditions of the contract had been fulfilled and either party can seek an order from the Court requiring specific performance (that is the transfer of the land title) of the agreement (most commonly known as when the agreement goes "unconditional").

18. A different interpretation is where the date of acquisition is determined by the nature of the interest in the land that is being disposed of (the "disposal" interpretation). Here, the date of acquisition would fall on the date the interest or estate is disposed of, which can occur at any point in the agreement, but is more than likely to be the later phases of a sale and purchase agreement—that is, either settlement or registration, or alternatively the date the agreement goes unconditional.



19. The application of these different interpretations can result in taxpayer uncertainty over which date to apply to their land transaction(s) and, in some cases, has had unintended tax outcomes. This has been a particular problem in situations when "land" is bought off the plans and a land title has not yet been registered.

20. The uncertainty in the law is also exacerbated by the fact that agreements for the sale and purchase of land may occur over a span of months or years, and interests in land can be assigned to another person before the purchaser's name is registered on the title.

21. The issues paper acknowledges that if the Government chooses to clarify the date of acquisition, taxpayers will have the opportunity to alter their behaviour under either interpretation to avoid having an intention or purpose of resale. The provision may also unintentionally capture some taxpayers. However, this risk exists currently and, on the whole, greater transparency should benefit all parties.

Comment

22. A fundamental consideration of a coherent, broad-base, low-rate tax system is that taxes should be efficient through minimising distortions and impediments to economic growth. This "efficiency" consideration also needs to be weighed against the opportunity for tax planning and providing a sustainable revenue base for the Government. I consider that amending the law will result in greater clarity and certainty for taxpayers.

Preferred policy interpretation and potential dates of acquisition

23. I consider that a "first interest" interpretation is the more appropriate interpretation from a tax policy perspective, and results in greater certainty and economic efficiency than the "disposal" interpretation. These reasons are discussed in more detail in the attached issues paper.

24. The issues paper therefore suggests (and provides supporting comments for each option) that, under the first interest interpretation, the taxpayer's purpose or intention should be tested on either:

- the date the sale and purchase agreement is entered into; or
- the date when all the conditions of the agreement for the sale and purchase of "land" have been fulfilled.

Evidence

25. The issues paper also discusses an evidence-related problem with the date of acquisition being set at the earlier phases of a sale and purchase agreement. The problem is that, if the date of acquisition is marked at the initial phases of an agreement for the sale and purchase of land, both the taxpayer and the Commissioner may have little evidence to prove/disprove their/the taxpayer's intention at this point in time.

26. This evidentiary problem does not affect providing certainty regarding the date of acquisition, but does present practical implications, particularly for the Commissioner, who has to determine what the taxpayer is thinking at a specific point in time.

27. The issues paper suggests an amendment to the law to allow the Commissioner and taxpayer to consider and submit evidence relates to before and after the date of acquisition,

albeit introducing an objective element to this provision. Therefore, if a dispute were to progress to the adjudication process or challenge procedures, the relevant deciding authority, when considering what the taxpayer's intention was, would ask, "what is the taxpayer's intention or purpose using all the reasonable information available to me?"

28. For ease of administration and in the interests of fairness, if at a later date the Government does agree to clarify the date of acquisition, the issues paper suggests that the date of application for any legislative option (that is, for new acquisitions as opposed to new disposals) be prospective, from the date of Royal assent of the relevant tax bill.

Consultation

29. The Treasury has been consulted in the preparation of this paper. A copy of the paper has been provided to Officials' Economic Growth and Infrastructure Committee and the Crown Law Office for their information.

Financial implications

30. The issues paper and any subsequent legislative amendment will not raise any revenue or system implications.

Legislative implications

31. If Cabinet subsequently agrees to legislatively clarify the acquisition date of land, I have asked officials to report back to us following submissions, within a timeframe that would allow any legislation to be included in a taxation bill scheduled for introduction in late 2013.

Regulatory impact analysis

32. A regulatory impact statement is not included at this stage of the policy process. A full regulatory impact statement would be included as part of any final report to Ministers. Officials confirm that the issues paper incorporates the substantive regulatory impact analysis elements required at this stage of the policy process.

Other implications

33. There are no human rights, gender or disability implications.

Publicity

34. The attached issues paper, subject to minor editorial changes, is almost ready to be released by officials.

35. If Cabinet agrees, I propose that the issues paper should be released as part of Budget 2013, in conjunction with the announcement of the continued funding of Inland Revenue's property compliance package.

36. I propose a six-week submission period.

Recommendations

I recommend that the Committee:

1. **Note** that section CB 6 of the Income Tax Act 2007, which deals with land acquired with the purpose or intention of disposal, and the taxation of income derived from disposal, causes considerable uncertainty for taxpayers, their agents and Inland Revenue.
2. **Note** that the key suggestions in the attached draft officials' issues paper, *Clarifying the acquisition date of land*, are:
 - 2.1 two possible options for a date of acquisition, based on events/phases of an agreement for the sale and purchase of land, either:
 - 2.1.1 the date the sale and purchase agreement is entered into and the equitable remedy of specific performance in the wide sense (injunction or otherwise) is available; or
 - 2.1.2 the date when all the conditions of the agreement for the sale and purchase of "land" have been fulfilled and the equitable remedy of specific performance in the strict sense is available.
 - 2.2 a legislative amendment that allows for evidence presented before and after the date of acquisition to be considered when determining what the taxpayer's intention was on the date of acquisition.
3. **Note** that, subject to Cabinet approval and minor editorial changes, I propose to release the attached issues paper as part of the Budget 2013 in conjunction with the announcement of the continued funding of Inland Revenue's property compliance package.
4. **Note** that the Minister of Revenue will issue a media statement to announce the release of the issues paper.

Hon Peter Dunne
Minister of Revenue

____ / ____ / ____
Date