



### WEEKLY COMMENT: FRIDAY 19 JULY 2013

1. This week I look at *Clarifying the acquisition date of land – An officials’ issues paper* (the “land acquisition IP”) released on 16 May 2013, following the government’s stated focus, in the 2013 Budget, “on ensuring that everyone pays their fair share of tax”. Submissions closed on 28 June 2013.
2. The discussion concerns determining the date on which land is acquired for the purposes of section CB 6 of the *Income Tax Act 2007*, which deals with land acquired for the purpose of, or with the intention of, disposal, and the taxation of income derived from disposing of the land.
3. A range of possible acquisition dates is discussed. A “first interest” interpretation is the preferred alternative, and *the date the agreement is entered into* is the preferred acquisition date under the “first interest” alternative.
4. The proposed application date of any legislative amendment is the date of Royal assent of the relevant tax bill – for new acquisitions (but not for new disposals – the position regarding disposals is left unclear).
5. While the focus is on section CB 6, it is noted that clarifying the date of acquisition will also increase certainty in relation to other land-taxing provisions:
  - (a) Section CB 15: clarifying that date on which land is acquired by associated persons for most of the land provisions in subpart CB;
  - (b) Sections CB 7, CB 9, CB 10, and CB 14: clarifying the date on which the 10-year period begins for a business dealing in land (including land development subdivisions, and change of land under the *Resource Management Act 1991*); and
  - (c) Sections CB 18 and CB 19: clarifying when land is acquired for the purposes of the residential and business exemption.

### IR 368 and the NZICA letter of 5 March 2010

6. If the preferred alternative becomes the legislated rule, the outcome for acquirers of land will be different from that currently set out in IR368 *Sold or thinking of selling property you purchased “off the plan?*, and particularly in the “Rebekah” example on page 5. This brochure was the subject of a detailed letter disagreeing with the outcome from the New Zealand Institute of Chartered Accountants (“NZICA”) to Inland Revenue written on 5 March 2010. The outcome espoused in the NZICA letter was that the acquisition date for the purposes of section CB 6 should be the date on which the agreement is entered into.

7. While the “Jeff” example, also on page 5 of IR368, appears to treat the “first interest” date as the acquisition date, NZICA also takes issue with this example on the grounds that, following *Jurgens & Doyle v CIR* (1990) 12 NZTC 7,074, “there is no taxable purpose where acquisition is without any definite purpose in view at all, or merely in the vague general hope that it would be a good investment ... Purpose or intention to sell are not to be equated with such mere future possibilities”.

### **Potential acquisition dates**

8. The following “phases of a sale and purchase agreement” and corresponding dates are identified in the land acquisition IP, and it is noted that the time periods between the phases may vary:
- (a) *Conditional agreement date*: the date on which the parties enter into the agreement, and an equitable interest is created in favour of the purchaser. Specific performance in the wide sense (injunction, caveat, or otherwise) is available to prevent the vendor dealing with the property inconsistently with the contract. It is noted, however, that:
    - (i) If an agreement is subject to “true conditions precedent”, a binding agreement will not be formed until the conditions are satisfied; but
    - (ii) An agreement that contains “conditions subsequent” is a binding contract; and
    - (iii) The commonly used Real Estate Institute and Auckland District Law Society standard form of agreement provides that conditions in the agreement are conditions subsequent, unless the agreement “expressly provides otherwise”.
  - (b) *Unconditional agreement date*: the date on which any conditions of the agreement (such as finance, solicitor’s checks and other findings, building report and LIM reports) have been fulfilled. The equitable remedy of specific performance in the “narrow sense” (an order requiring the transfer of title) is available to the purchaser.
  - (c) *Settlement date*: the date on which the purchaser gives or makes available the purchase price to the vendor and there is a conveyance of the title to the purchaser.
  - (d) *Registration of title date*: the date on which documentation evidencing the purchaser’s right to the legal estate is registered under the *Land Transfer Act 1952*, and act conferred by the Registrar-General of Lands and the legal estate is acquired by the purchaser.

### **Uncertainty regarding acquisition date and possible interpretations**

9. It is noted that there can be some uncertainty regarding when land is acquired, because existing case law can result in different interpretations:
- (a) The date land was acquired in the tax case *Beetham v CIR* 72 ATC 6042 was the date on which the contract became unconditional and an order for specific performance of the land transfer was available (refer to pages 17-18 of the NZICA letter); whereas
  - (b) In the non-tax case *Bevin v Smith* [1994] 3 NZLR 648, it was held that under the general law a purchaser acquires an equitable interest in land if specific performance in its wider sense (e.g. caveat or damages) is available to protect the purchaser’s rights under the contract (see pages 10-11 of the NZICA letter).
10. These case law distinctions can, in turn, result in differing interpretations of when land is acquired for the purposes of section CB 6:

- (a) If *Bevan v Smith* is followed, the date of acquisition would be the date on which the agreement was entered into; whereas
  - (b) If *Beetham* is followed, the acquisition date would be the date when all conditions of the contract had been fulfilled, when the agreement became unconditional.
11. A third interpretation is also discussed: the “disposal interpretation”. Here, the date of acquisition would fall on the date the taxpayer acquires the interest or estate that is subsequently disposed of, which could be as late as when the land title is registered.
12. It is acknowledged that these differing interpretations can give rise to particular problems when land is bought off the plans and a land title has not yet been registered. In addition, interests in land can often be assigned before the purchaser’s name is registered on the title.
13. Example A on page 9 of the land acquisition IP highlights the problem in the “Rebekah” example in IR368: a change of intention between the time an agreement is signed and the time the title is registered will result in taxable income under the “disposal interpretation”, but not under the “first interest” interpretation.

#### **Reasons why officials prefer the “first interest” interpretation**

14. Officials consider that the “first interest” interpretation is the most appropriate from a tax policy perspective for the following reasons:
- (a) A person’s intention can change between the date an agreement is entered into and a subsequent date: this is highlighted in Example A referred to in paragraph 13 above;
  - (b) There is more potential to distort behavior if the “disposal” interpretation is followed: a person desiring certainty may delay entering into an agreement until the title is nearly ready; alternatively, a person wishing to manipulate the rules may dispose of land before a title is acquired so as to claim a loss if land values are decreasing;
  - (c) Developers could be adversely affected if people’s decisions to invest are delayed due to tax considerations; and
  - (d) While there may be cases where an acquisition date cannot be determined before disposal – for example, in the case of some lease assignments – in most cases there will be some form of earlier agreement that can be relied on.

#### **The two alternative acquisition dates under the “first interest” interpretation**

15. Officials consider that there are two main alternative times of acquisition under the “first interest” interpretation:
- (a) The *date an agreement is entered into* (in the case of an option, this would be the date on which the option is granted); this alternative will have the following characteristics:
    - (i) A clear decision will be required at the time the agreement is entered into;
    - (ii) The date of entry into an agreement will, in most cases, be clearly identifiable without controversy;
    - (iii) There will be an “equitable bright line” in the sense that the taxpayer will have acquired an equitable interest and a Court could order specific performance in the wider sense (such as injunction or caveat, or an award for damages);

- (iv) There is, however, not likely to be much evidence at this point in time to prove the taxpayer's intention or purpose.
  - (b) The *date on which an agreement becomes unconditional* (which, in the case of an option, would be the date the option is exercised); this alternative will have the following characteristics:
    - (i) No clear decision will be required at the time the agreement is entered into, as some further actions will normally be required before the agreement becomes unconditional;
    - (ii) The actual date on which the conditions are fulfilled is not likely to be as clear in this case, because of reliance on third parties to fulfill the conditions;
    - (iii) There will be an equitable bright line in the sense that a Court could order specific performance – for example, ordering the transfer of the land title;
    - (iv) There is likely to be more evidence available by this time to prove or disprove the taxpayer's intention (the example given is of a short-term finance arrangement being indicative of an intention to sell).
16. A number of possible specific times have been mooted in relation to each of these alternatives on which submissions were requested. In relation to the time the agreement is entered into, the possible dates are:
- (a) The date a binding agreement is signed by the vendor or purchaser (including nominees or agents); or
  - (b) The "Date" indicated on a binding sale and purchase agreement, which is then subsequently signed by the parties to the agreement; or
  - (c) The date a binding oral agreement for the disposal of land was agreed to by the parties, which has then been subsequently actioned by part performance of the agreement and if required later, evidenced by a memorandum; or
  - (d) The date the first equitable estate or interest in land is acquired under a binding agreement for the sale and purchase of land and specific performance in the wider sense of all equitable remedies is potentially available to the purchaser (such as injunction or award for damages).
17. In relation to the time an agreement becomes unconditional, the possible dates are:
- (a) The date when all conditions agreed to by the parties, subsequent to the entering into the sale and purchase agreement are all fulfilled; or
  - (b) The date an equitable estate or interest in land is acquired under a binding sale and purchase agreement, and specific performance in the strict sense is potentially available to the purchaser (that is, a Court order requiring the agreement to be performed in accordance with the terms of the agreement by ordering the transfer of the land title).

### **Officials' preference**

18. Officials prefer the date an agreement is entered into for the following reasons:

- (a) As the policy intent of section CB 6 is to capture property speculators, the most appropriate time to assess a taxpayer's intention is when the taxpayer enters into an agreement;

- (b) It is the initial decision-making that informs how a person intends to use the property;
- (c) There is more likely than not as clear date or “bright line” of when the agreement was entered into.

19. Officials acknowledge, however, that there is not likely to be much evidence of a taxpayer’s intention at this time. Therefore, officials have suggested introducing legislation to allow the Commissioner and the taxpayer to consider and submit evidence that is before and after the date of acquisition. Officials note that it is arguable that this is already the situation, given that the Courts have held that purpose or intention must be determined on the totality of the evidence: *Case Y3* (2007) 23 NZTC 13,028. However, introducing legislation is suggested so as to ensure that the Court considers evidence before and after the date of acquisition, and not just the totality of evidence at the date of acquisition.



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