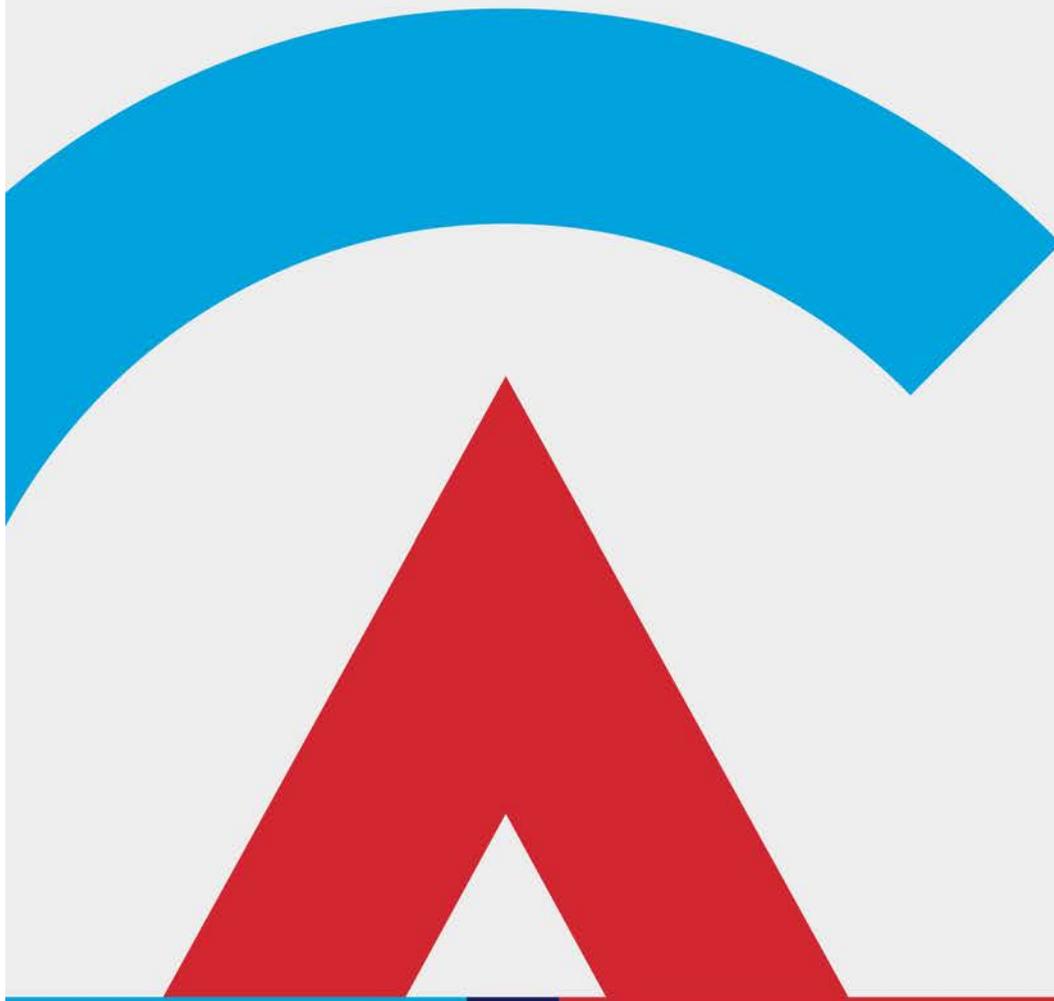


Habitual buying and selling of land

A consultation document

17 October 2019



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Habitual buying and selling of land

Chartered Accountants Australia and New Zealand (CA ANZ) appreciates the opportunity to provide feedback on the consultation document “Habitual buying and selling of land”.

Possible solutions are canvassed in the consultation document that will prevent taxpayers, who regularly buy and sell land, from structuring their land transactions to take advantage of the main home, residential and business premises exclusions.

Our key recommendations are:

- the proposed amendments should be limited to the main home or residential exclusions;
- “group of persons or entities” should be clarified;
- there should be some flexibility in the proposed amendments to allow for extenuating circumstances;
- care is needed in widening/liberalising as to what may constitute a pattern;

- a time period restriction of more than twice in three years should be given more consideration; and
- the proposed amendments should specifically state the exclusion does not apply where the property was purchased for the intention of resale.

Please contact us if you wish to discuss our submission.

Yours sincerely



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Habitual buying and selling of land

Introduction

The Government's tax policy programme has identified a need to review the current land sale rules. However, the consultation document is limited to only addressing a problem with the regular pattern restrictions in the land taxing rules. We understand from Officials that due to time constraints it was only possible to focus on this one narrow area rather than undertaking a full review of the land provisions. Work on other areas of the land tax rules will be undertaken in the future. CA ANZ believes a comprehensive review is more appropriate. Amending the land taxing rules on an ad hoc basis may create further distortions and impact the overall coherence of these rules.

Overview

The land taxing rules contain exemptions for taxpayers who occupy the land as their main home, residence or business premises. However, these exemptions are not supposed to apply where the taxpayer has engaged in a regular pattern of buying and selling land that is used for these purposes. Inland Revenue have expressed concerns that the current regular pattern restrictions are not working as intended.

The relevant provisions are:

- s CB 16A(2)(b) - main home exclusion for the bright-line test;
- s CB 16 (3) - residential exclusion from sections CB 6 to CB 11; and
- s CB 19(2) - business premises exclusion from sections CB 6 to CB 11.

Group of persons or entities

Currently all of the regular pattern restrictions apply quite narrowly to the activities of a single person. Taxpayers have been able to use different but associated entities to conclude land transactions to avoid the regular pattern restrictions.

Proposal

To amend the rules so that the regular pattern restriction applies where a person or **a group of persons**, has a regular pattern of buying and selling land that has been:

- occupied by the person or group of people as their main home, residence or business premises (as applicable); or
- occupied as a main home, residence or business premises (as applicable) by the person or group of people that controls the entity or entities that own the land.

Comment

The proposed amendment incorporate two components:

1. A group of persons or entities; and
2. That group of persons or entities occupies the land as a residence or main home or business premises.

The consultation document suggests that the current regular pattern restrictions are being circumvented by using different but associated persons or entities¹. All the examples in the consultation document are based on a group of “**associated**” persons or entities.

It is notable that the proposed amendment applies to “**a group of persons or entities**” not “a group of **associated** persons or entities”. Further, the consultation document is silent on how a “group of persons” will be defined. It is not clear whether the omission of a

¹ Consultation document paragraphs 2; 9; 11;

definition is deliberate because “a group of persons or entities” does not need to be defined or restricted to a group of associated or related persons or entities. The common link between the group of persons or entities will be that all the homes, residences or business premises, that have been bought and sold, are occupied by the same group of persons or entities or group of persons that “**controls**” the entity/entities that own the land.

The consultation document does not explain what is meant by “**control**” although we expect “**control**” would include the power to appoint or remove trustees of the trust or where the persons in aggregate have a threshold level of voting or market value interest in the entity or entities.

For example, two unrelated friends (Person A and Person B) have bought, renovated and sold five residential properties over 7 years. Both Person A and Person B live in each property while renovating them. The first property was purchased by Person A, the second property was purchased by Person B, the third property was purchased by B Trust (a trust settled by Person B); the fourth property was purchased jointly by Person A and Person B and the fifth property was purchased by Person A.

Under the current rules, the regular pattern restriction would not apply.

We assume under the proposed amendment; the regular pattern restriction would apply because **the group of people** (Person A and Person B (in their personal capacity and their capacity as a beneficiary of Trust B)) **have occupied** all five of the residential properties.

It would not be appropriate to draw in the separate activities of a group of people to establish a pattern i.e. where Person A and Person B have separately purchased and lived in their own properties and only come together for a common activity via a Trust.

Legislation will need to be clear that a “group of persons” can include a trustee if one or more beneficiaries occupies the residence or business premises.

If our understanding is incorrect and it is intended that only associated persons can be a “**group of persons or entities**” Officials must address what set of associated person rules will apply. If the associated person definition, as it applies to the land rules, is used it will still aggregate transactions of potentially a wide group of persons.

Business premises exclusion

In our view there is a lack of evidence to support the assertion that the regular pattern restrictions buttressing the business premises exclusion are not working as intended. CA ANZ does not consider that the proposed changes need to be extended to the business premises exclusion. Based on the examples set out in the consultation document, the existing rules should be sufficient to catch transactions that should be taxed in a business premises context. Expanding the proposed rule to the business premises exclusion will give rise to a number of problems.

Example 2 relies on the application of section CB 19. Notably, section CB 19 only applies to a person who acquired and occupied or erected and occupied the premises mainly to carry on a substantial business from them. This is not the case based on the fact pattern provided. In example 2, G carries on a piano tuning business. Separate companies that are wholly owned by G buy and sell the business premises that are used by G. Given that the current section CB 19 would not apply to provide an exclusion in the first instance (because G does not personally own the business premises) we are not convinced that there is a need to broaden the regular pattern restriction to limit use of the business premises exclusion to cover this type of scenario.

Examples 3 and 4 in the consultation document centre around holding companies and their subsidiaries. Further, in determining whether there is a regular pattern, consideration is also given to whether the land was “acquired with an intention of resale”.

If the application of the proposed rule to business premises is deemed necessary, there is a need to ensure that it does not result in overreach. In our view, it would be sensible to explicitly expand the proposed business premises regular pattern restriction to incorporate an additional qualification that “the land was acquired with an intention of resale” as discussed in Example 3 in the consultation document. The inclusion of this additional test would help ensure transactions that occur as a legitimate part of expanding the business are not caught. However, we acknowledge that purpose or intention relies on a subjective test which may impact Inland Revenue’s ability to practically enforce. If this additional qualification is not included, we believe the proposed amendment would result in overreach.

We note that this issue already exists in the case of a company that operates its businesses with a branch structure, as there is one legal entity that occupies all of the branch business premises. We therefore recommend that an “intention of resale” qualification is introduced to limit the application of the existing regular pattern restriction notwithstanding we consider the proposed new “group of persons or entities” rule should be limited to residential property and not business premises.

A branch structure can be contrasted with a holding company and its subsidiaries that each have their own business premises. Outside of a tax consolidated group (or perhaps a wholly owned group), “the group of subsidiaries” would not occupy **each business premise**, therefore the proposed amendment would not apply.

If our interpretation is correct, i.e. each subsidiary only occupies its own premises (and does not commonly own/occupy land of its fellow subsidiaries), then example 3 and 4 would

be redundant. Example 3, although arriving at the correct outcome as there is no intention of resale, makes reference to the fact that “the group has regularly bought and sold land over the 10-year period...” Consideration of the “group” in this context does not reconcile to our common land occupation interpretation. The same situation exists in example 4 as the group of entities do not “all occupy” each of the properties as stated in paragraph 11 of the consultation document.

Similar activities

The regular pattern restrictions in sections CB 16 and CB 19 have been interpreted very narrowly by the Courts and only apply to a regular pattern of very similar activity.

Proposal

To broaden the scope of the regular pattern restrictions to apply to all patterns of buying and selling land used as a residence or business premise. For example, 1. buy residence and sell; 2. buy, renovate residence and sell; 3. buy land, build residence and sell.

Comment

There is an assumption that where there is a regular pattern of buying and selling land a person or group of persons are acquiring the land with the intention of disposal and should be taxed on the sale. However, this is not always the case and there should be some flexibility in the proposed amendments to allow for extenuating circumstances including involuntary situations. For example, breakup; change of location for work/retirement; financial duress.

Care is needed in widening/liberalising as to what may constitute a “pattern” because it is likely to increase capture of transactions which viewed objectively should never be caught. That is, establish a pattern where one is not present.

The Courts have held that the word ‘pattern’ in the phrase “a regular pattern of such transactions” denotes a similarity or likeness in the transactions. In addition, the word “regular” is used in the sense of recurring at uniform or near-uniform intervals.

We believe it may still be appropriate for a pattern of acquisition and disposal to be treated as regular, provided that the transactions occur, within reason at sufficient uniform or consistent intervals. Identifying what is a uniform or near uniform interval may be problematic. For example, it is difficult to see how periods ranging from 6 months to 26 months could be regarded as uniform.

To avoid any unnecessary problems with applying the proposed rules, clear guidance will need to be provided on what is meant by “uniform or near-uniform intervals”. What constitutes a regular pattern is not tested by the vanilla fact pattern currently used in example 5.

Time period restrictions

The main home exclusion in the bright-line test (section CB 16A) contains a regular pattern restriction and also includes a cap on how frequently the main home exclusion can be used. The exclusion cannot be used more than twice in a two-year period.

Proposal

To include a time-period restriction of more than twice in three years for sections CB 16 and CB 19.

Comment

As stated above, we do not consider that the business premises regular pattern restriction should be broadened. However, if amendments to the business premises restriction (section CB 19) proceed, we do not believe that a time period restriction in this context

would be appropriate. A large corporate should not become liable to tax because it sold an arbitrary number of business premises in a defined period (unless of course it acquired them for resale and had established a regular pattern such that the business premises exemption would not apply in any event).

With regard to the residential premises exclusion (section CB 16), a time period restriction may be a useful supplement as it will provide an objective test. It would be easier for a taxpayer and Inland Revenue to apply rather than assessing whether there is a regular pattern under the current rules and under any proposed changes.

The proposed time period restriction of more than twice in three years should be given more consideration. For consistency it would be appropriate to align it with the current cap for the bright-line test which is twice in a two-year period. A longer period may be problematic and catch normal family transactions. For example, the current median 'hold period' (years between purchase and resale) is 7.4 years². In 2016 the median was 8.2 years whereas in 2007 it was 3.8 years. Furthermore, Auckland has shorter 'hold periods' than the rest of New Zealand.

Presumably, the inclusion of a period restriction would operate as a bright-line test and only the additional transactions that occur inside this period would be caught irrespective of whether there was a regular pattern and no intention of resale. Transactions outside this period could still be caught if they occur at sufficient uniform or consistent intervals³. Guidance should be provided on what is a sufficient uniform or consistent interval.

It should be noted that although a cap on the number of transactions and the imposition of a time period restriction may provide taxpayer certainty, it could influence taxpayer behavior

² <https://www.corelogic.co.nz/news/how-long-do-owners-hold-their-properties#.XWSRsfkzaUk>

³ QB 16/07

and create an incentive to hold property for longer periods. Those taxpayers who have to sell due to circumstances beyond their control are most likely to be caught by the rule.

Other considerations

Officials consider that the proposed amendments to the regular pattern restrictions should not result in ordinary commercial or family transactions, being taxed, where there is no purpose of sale.

Paragraph 20 states:

*“the regular pattern restrictions require amendment to ensure that taxpayers cannot structure around them, **it is not intended that such amendments should result in ordinary commercial or family transactions, where there is no purpose of sale, being taxed” (emphasis added).***

Question

Whether the proposed amendments to the regular pattern restrictions are likely to capture these types of transactions?

Comment

As noted above in our comments on the business premises exclusion, the proposed amendments significantly increase the likelihood of these types of transactions being captured and a limitation is required such that the regular pattern restriction only applies where there is an intention of resale.

The expectation that property which is not acquired with a purpose of sale should not be captured by the regular pattern restriction is significant.

It must be acknowledged that any property acquired by a person, may and probably will ultimately be sold at some time in the future. Purpose or intention to sell are not to be equated with such mere future possibilities".⁴ It is likely that taxpayers will buy and sell a number of properties over their life time as their circumstances change. As noted above the current median hold period is 7.4 years. Normal family transactions can generally be distinguished from those accelerated transactions where there is a purpose or intention to dispose of the property and sweat equity is used to renovate or enhance that property.

An amendment to specifically state that the exclusion does not apply where the property was purchased for the intention of resale would help ensure that normal family transactions are not caught.

As a general observation, to avoid catching normal family/business transactions which may come to light in the future, we recommend any changes specifically target the mischief you are trying to address which we consider is residential property rather than business premises.

Other issues

Comment

To ensure consistency, the consultation document should consider consolidating and rationalising ss CB 16A(2)(b) and CB 16(3).

⁴ Jurgens & Doyle v C of IR [1990] 12 NZTC 7,074 at 7,081