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WEEKLY COMMENT: FRIDAY 18 MARCH 2016

1. Draft Question We've Been Asked *Income tax – Date of acquisition of land* (“the draft QWBA”) was released by Inland Revenue on 6 August 2015. A final version has not yet been issued. This week I review the draft QWBA, which deals with when land is acquired under s. CB 15B of the *Income Tax Act 2007*, due to its relevance for determining whether land is acquired before or after 1 October 2015 for the purpose of applying the bright-line test.
2. Section CB 15B does not apply to the bright-line test itself – i.e. it does not determine the date of acquisition of land for the purposes of determining whether a disposal occurs within 2 years. It applies to determine whether land is acquired on or after 1 October 2015 to see if the land sale could be subject to the bright-line test.
3. An important point, as noted in the draft QWBA, is that the date of acquisition of the land under s. CB 15B will, in most cases, not be the date on which it is disposed of by the vendor. The draft QWBA does not deal with the date of disposal of land. I will consider some issues relating to determining the date of disposal of land next week.

What s. CB 15B states

4. Section CB 15B states that for the purposes of subpart CB (which include all the rules relating to the taxation of income from disposals of land) except s. CB 6A (i.e. except for the bright-line test rules):
 - (a) A person acquires an estate, interest, or option that is land on the date that begins a period in which the person has an estate or interest in, or an option to acquire, the land, alone or jointly or in common with another person.
 - (b) If the person acts on behalf of a company to be formed, the company is treated as existing from when the person enters the agreement.
 - (c) If a person who has an estate or interest in land has subsequently, as a consequence of the person's exercise of an option, another (i.e. a different) estate or interest in the same land, the person is treated as having the other (i.e. the different) land interest from the time of the exercise of the option.
 - (d) The above rules are overridden by the rules in subparts FB and FC, which deal with transfers upon death, transfers to beneficiaries, gifts and relationship property transfers.
5. It is stated in the draft QWBA that due to the way that “land” is defined in s. YA 1, it is possible to acquire different interests at different times, with each interest being regarded as “land”, in the same piece of underlying physical land. The reference in s. CB 15B(1) to the date “that

begins the period in which the person has an estate or interest in, or an option to acquire, the land” means that it is the first interest in the land that is relevant.

6. “Land” in s. YA 1 includes:

(a) Any estate or interest in land (which means any legal or equitable estate whether vested or contingent, including a right to possession and receipt of rents or profits, and has been expanded to include any interest in land and a licence to occupy a flat or office as a shareholder, as I discussed in *Weekly Comment* 19 February 2016);

(b) An option to acquire land or an estate or interest in land.

7. It is stated in the draft QWBA that while different interests that are each “land” in their own right may be acquired at different times, what is relevant is when the land that is disposed of was acquired. The example given is of a disposal of a freehold estate in fee simple, and the question is when that land – i.e. the freehold estate – was acquired. This would be the case even if, for example, the person previously had a leasehold interest in the land – the time at which the freehold estate arose is the relevant time of acquisition.

8. Section CB 15B has applied to disposals of land from 22 November 2013, and can be applied retrospectively to land acquired before 22 November 2013 that has not been disposed of. The Commissioner accepted in *Tax Information Bulletin* Vol. 26 No. 7 August 2014 (“the TIB Item”) that for land that has been disposed of, the previous interpretation of the acquisition date (usually in the later stages of a sale and purchase agreement after the “first interest” had been acquired) would continue to be accepted such that previous tax positions would not need to be unwound.

Which sections CB 15B applies to

9. A number of provisions in subpart CB require identification of when a person acquired land:

(a) Section CB 6 includes as income an amount that is derived from the disposition of land if the taxpayer acquired the land for one or more purposes or intentions that included the purpose or intention of disposing of the land, therefore, the taxpayer’s purposes and intentions must therefore be tested as at the time they acquired the land.

(b) Section CB 7 applies to tax the proceeds from the disposal of land if, at the time the land was acquired, the taxpayer or an associated person carried on a business of dealing in land, or of developing land or dividing the land into lots or of erecting buildings and the land was acquired for the purpose of any of such businesses;

(c) Sections CB 9, CB 10, and CB 11 apply if land is sold within 10 years of acquiring it and a business of dealing in land, or of developing land or dividing the land into lots or of erecting buildings and the land was carried on by the taxpayer or an associated person at the time the land was acquired;

(d) Section CB 12 applies if an undertaking or scheme was begun within 10 years of the date on which the taxpayer acquired the land;

(e) Section CB 14 applies if land is disposed of within 10 years of acquiring it and at least 20% of the gain from sale relates zoning or regulatory changes;

(f) The residential and business exclusions in sections CB 18 and CB 19 require ascertaining the intentions of the taxpayer at the time of acquisition.

When a first interest is acquired

10. As noted in the draft QWBA, the legislation does not specify when a person is first considered to have an estate or interest in land.
11. It is stated in the TIB Item and also in the *Commentary to the Bill* (“the Commentary”) when the legislation was introduced (the draft QWBA refers to the explanation in the Commentary) that practically, this means the date a binding agreement is entered into. Indicative characteristics of the date a binding agreement is entered into (that is, the agreement has no conditions precedent, but the vendor and the purchaser intend to be bound by the terms of the contract even if there are conditions subsequent that have to be fulfilled) are:
 - (a) The date a binding sale and purchase agreement has been signed and executed by both 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.
12. Reference is made in draft QWBA to *Bevin v Smith* [1994] 3 NZLR 648 (CA), where it was held that a purchaser has an equitable interest in land from the time a binding contract exists, even if it is conditional. This is when equitable remedies are available to protect the purchaser’s rights under the contract, though specific performance in the strict sense (i.e., for the transfer of title) would not yet be available. The conclusion in the draft QWBA is that land is to be regarded as acquired, for tax purposes, when the first estate or interest in the relevant land arises, even if specific performance in the strict sense would not yet be available.

Examples in the QWBA of when a first interest is acquired

13. There are two examples provided in the QWBA of when a first interest arises:
 - (a) Example 1: A binding sale and purchase agreement to acquire land was entered into subject to the purchaser obtaining satisfactory LIM and building reports within a specified timeframe and these conditions were fulfilled. The acquisition date is the date of entry into the binding sale and purchase agreement (i.e. before the agreement became unconditional). Even though the agreement was subject to conditions, the date of entry into the binding sale and purchase agreement was when the purchaser first had an equitable interest in the land.
 - (b) Example 2: A binding sale and purchase agreement to acquire a freehold interest in land that was already being leased by the purchaser was entered into subject to the purchaser obtaining finance and the condition was fulfilled. The acquisition date is the date of entry into the binding sale and purchase agreement to acquire the freehold interest in the land (i.e. before the agreement became unconditional). The fact the purchaser previously had a leasehold interest is not relevant, as it is the disposal of the freehold interest that would give rise to a taxing event.

When a first interest arises when land is acquired by way of an option

14. An option to acquire land is included in the definition of “land” in s. YA 1 (see **paragraph 6(b)** above). The draft QWBA discusses the meaning of an option as follows:
- “An option may be described, in short, as an offer to sell, together with a contract not to revoke the offer (see, for example, *Alexander v Tse* [1988] 1 NZLR 318 (CA), and DW McMorland, *Sale of Land* (3rd ed, Cathcart Trust, Auckland, 2011) at 3.16). It may be a right contained within a lease, or granted separately.”
15. It is stated in the draft QWBA that where land is acquired by way of exercise of an option, the first estate or interest in the land will typically arise when the option is granted. At that point the grantee will have an equitable interest in the land: *Motor Works Ltd v Westminster Auto Services Ltd* [1997] 1 NZLR 762 (HC).
16. It is also noted that the Commentary confirms that the date a binding agreement is entered into will be the date a taxpayer acquires an option but has not yet exercised it. Although the option is yet to be exercised and the parties still have to enter into a subsequent agreement for the sale and purchase of the land pertaining to the option, the taxpayer has acquired an equitable interest in the “land”, which is the first interest.
17. This outcome is clearly implied by the exception in s. CB 15B(3) which refers to a “another estate or interest in the same land” at the time of exercise of an option, in which case, the person is treated as having the other (i.e. the different) land interest from the time of the exercise of the option (as opposed to from the time the option was granted. This exception would not be necessary if the date of entry into the option was not the acquisition date.
18. The discussion in the draft QWBA differs from the discussion in the TIB Item regarding the situation the exception in s. CB 15B(3) refers to. In the TIB Item, an example is given of a first right to acquire a freehold interest in land that was already being leased by the purchaser, to demonstrate the application of the exception. The exercise of the first right gives rise to a different interest, and a new acquisition date (as opposed to the date the first right was granted).
19. In the draft QWBA, it is stated that a first right is not an option at all. Therefore, the grant of a first right does not reflect a date of entry into an option and the exception in s. CB 15B(3) has no application in such circumstances. There is no option, and the acquisition date is the date a first interest in the subsequent freehold interest is obtained (though it is conceded that in some rare situations it could be the date of an earlier “triggering event” requiring an offer to be made to the holder of the first right option). It is stated that:
- “Unlike the holder of a call option (an option to buy), the holder of a “first right option” does not have an equitable interest in the land to which the “option” relates. It will typically be when the owner makes an offer in accordance with the “first right option” that the holder acquires an equitable interest in the land in question (*Motor Works Ltd v Westminster Auto Services Ltd*). The holder does not acquire an equitable interest in the land **as a consequence of** their exercise of the “first right option”, because they will have (typically) acquired their equitable interest when the offer was made to them.”

Examples in the QWBA where an option or a first right is involved

20. The draft QWBA contains the following examples where an option or a “first right” is involved:
- (a) Example 3: An option was purchased to buy land and duly exercised, therefore, the purchaser acquired the land when he acquired the option, as that was when he first had an equitable interest in the land.
 - (b) Example 4: A lease of business premises is entered into and at the same time an option was acquired to purchase the premises (i.e. land), which was duly exercised. Therefore, the time the land was acquired was when the option was acquired because that was when the purchaser’s equitable interest in the freehold arose – it did not arise as a result of exercising the option, therefore the exception in s. CB 15B(3) does not apply.
 - (c) Example 5: A lease was entered into and an option to acquire the land was acquired some time later. The option was duly exercised. Again, the time the land was acquired was when the option was acquired because that was when the purchaser’s equitable interest in the freehold arose – it did not arise as a result of exercising the option, therefore the exception in s. CB 15B(3) does not apply.
 - (d) Example 6: A lease was entered into with a “first right” option to acquire the land should the owner decide to sell it. The owner subsequently made an offer to the lessee, which was accepted. The time the land was acquired by the lessee was when the offer was made in accordance with the first right option. The exception in s. CB 15B(3) does not apply because the equitable interest in the freehold estate did not arise as a result of the lessee accepting the offer, but rather, through the making of the offer.

When an option that is subsequently sold was acquired

21. The time when an option is acquired is relevant if the option itself is sold, because an option to acquire land is itself “land”. It is stated in the draft QWBA that under s. CB 15B an option will be acquired when a binding agreement for its acquisition is entered into.

Acquisition of land by a company to be formed

22. When a person enters into an agreement to buy land on behalf of a company to be formed, s. CB 15B(2) states the company is treated as existing from when the person enters into the agreement. Therefore, the date of acquisition of the land by the company will be the date that the person enters into the agreement that gives rise to the first interest in the land.

Date of acquisition rules in subparts FB and FC override s. CB 15B

23. It is noted in the draft QWBA that the date of acquisition rules in s. CB 15B are overridden, for a particular transaction, by any relevant provision in either subpart FB or subpart FC (which deal with relationship property, distributions on death, distributions from a trust, transfers of value from a company, and gifts of property).



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