Vol 28 No 8 September 2016

TAX INFORMATION *Bulletin*

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Inland Revenue
Te Tari Taake

Classified Inland Revenue - Public
ISSN 1177-620X (Online)

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Inland Revenue regularly produces a number of statements and rulings aimed at explaining how taxation law affects taxpayers and their agents. Because we are keen to produce items that accurately and fairly reflect taxation legislation and are useful in practical situations, your input into the process, as a user of that legislation, is highly valued.

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IN SUMMARY

INTERPRETATION STATEMENTS

This section of the *TIB* contains interpretation statements issued by the Commissioner of Inland Revenue.

These statements set out the Commissioner's view on how the law applies to a particular set of circumstances when it is either not possible or not appropriate to issue a binding public ruling.

In most cases Inland Revenue will assess taxpayers in line with the following interpretation statements. However, our statutory duty is to make correct assessments, so we may not necessarily assess taxpayers on the basis of earlier advice if at the time of the assessment we consider that the earlier advice is not consistent with the law.

IS 16/02: INCOME TAX – UNIT TRUSTS – WHEN A UNIT TRUST CAN HAVE A SINGLE UNIT HOLDER

All legislative references are to the Income Tax Act 2007 (the Act) unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this Interpretation Statement.

Summary

1. This interpretation statement sets out the Commissioner's position on whether and when a unit trust can have a single unit holder for income tax purposes. A unit trust is a type of trust that is treated as a company for income tax purposes.

2. The commentary to BR Pub 95/5A: "Relationship between the 'unit trust' and 'qualifying trust' definitions" stated that a unit trust must have more than one unit holder. The Commissioner has been asked to reconsider this position. This statement sets out the Commissioner's revised position.

3. The statement considers three issues. The first issue is whether a unit trust always needs more than one unit holder. It is concluded that a unit trust does not always need more than one unit holder. Rather, the "unit trust" definition requires only that the trust scheme or arrangement is "made for the purpose" or "has the effect" of **providing facilities** for multiple (more than one) unit holders.

4. The second issue is whether the "numbers rule" in s 33 of the Interpretation Act 1999 means that the "unit trust" definition can be satisfied even where facilities are provided for only one unit holder. The Interpretation Act provides that, unless the context requires a different interpretation, words in the Income Tax Act in the singular include the plural and words in the plural include the singular. If this interpretation was applied to the definition of "unit trust", it would only be necessary for a unit trust to provide facilities for one unit holder.

5. However, the numbers rule does not always apply. Case law on the numbers rule shows that it is necessary to determine whether Parliament would have intended for the words in a provision to be read in the singular or plural. This requires consideration of the purpose of the provision, its text and its context in the enactment.

6. At the time the definition was enacted, unit trusts were not commonly used in New Zealand and existing ones were all widely-held investment vehicles. Further, the unit trust regime in the Income Tax Act was enacted to ensure that investors could not use unit trusts to avoid the two levels of taxation that were imposed on companies under the classical system of taxation. At the time, the companies legislation required companies to have more than one shareholder. In the Commissioner's view, Parliament would not have intended the "unit trust" definition to apply to a trust that could only have a single unit holder. Therefore, a unit trust must provide facilities for multiple subscribers to meet the Income Tax Act definition.

7. The third issue is when a trust with a single unit holder will be a unit trust. As noted above, to be a unit trust a trust must be **made for the purpose or have the effect of** providing facilities for multiple unit holders. There are two main ways that this requirement could be interpreted. The first is that it is determined purely by examining whether the legal relationships provide facilities for multiple unit holders. The second possibility is that there must also be an intention for the trust to have multiple unit holders. Either interpretation is available on the words.

8. On balance, the Commissioner concludes that whether a trust is made for the purpose or has the effect of providing facilities for multiple unit holders to invest should be determined by considering the legal relationships governing the

trust – most importantly, the trust deed. Under this interpretation, the essential feature of a unit trust is the provision of the facilities for subscribers to participate, and that is not altered by there being only one subscriber.

9. The main reason for this conclusion is based on the workability of the different interpretations. Under this approach, the relevant inquiry is not a factual one to determine whether, in practice, multiple persons are actually participating in the facilities provided. Therefore, an entity can be a unit trust within the definition if there is only one subscriber, provided there are facilities for multiple subscribers. An interpretation that considers only legal relationships means that a unit trust that satisfies the test will always do so (barring any change to its trust deed). It is also easy to determine whether a trust provides facilities for multiple unit holders by looking at the legal arrangements.

10. On the other hand, intention can change over time. Therefore, an interpretation that takes account of intention could mean that a trust falls in and out of the unit trust regime as intentions change. It may also be difficult to determine whether the requisite intention exists at any given time – making the test potentially difficult to apply. It seems unlikely that this would have been Parliament's intention when enacting the provision. Consequently, on balance, the Commissioner's view is that the purpose of the "unit trust" definition is most consistent with a legal relationships test. Given this, it is not necessary to establish an intention for a trust to have multiple unit holders.

Introduction

11. This statement sets out the Commissioner's position on whether and when a unit trust can have a single unit holder. Determining whether a trust is a "unit trust" for income tax purposes is important as the tax treatment is different. Unit trusts are treated as companies for income tax purposes; whereas other trusts are subject to the trust rules.

12. The commentary to BR Pub 95/5A: "Relationship between the 'unit trust' and 'qualifying trust' definitions" (*Tax Information Bulletin* Vol 8, No 10 (December 1996): 15) included the following statement:

> The [unit] trust must have more than one unit holder. The use of the plural when referring to "subscribers, purchasers, or contributors" in the definition [of unit trust] supports this interpretation.

13. BR Pub 95/5A and its commentary were concerned with the issue of whether a unit trust is taxed as a trust or a company. The issue arose because a unit trust could potentially be within the definition of "qualifying trust" and also treated as a company under the Act. The ruling concluded that the company rules apply. The statement that the definition of "unit trust" requires more than one unit holder was not central to the discussion and conclusion. However, it does represent the Commissioner's published view on that point.

14. BR Pub 95/5A applied from the 1997/98 income year to the 1999/2000 income year. In *Tax Information Bulletin* Vol 12, No 5 (May 2000): 4, the Commissioner stated:

> The Commissioner has determined that upon expiry the above-referenced public ruling [BR Pub 95/5A] will not be re-issued.
>
> It is considered that the legislation on the subject matter covered by the ruling is clear.
>
> The non-renewal of the ruling should not be taken as indication of change to the interpretation of the legislation as set out in the ruling. The Commissioner's view on the issue remains the same.

15. The Commissioner has been asked to reconsider whether a unit trust requires more than one unit holder and when this is possible. To the extent that BR Pub 95/5A (in conjunction with the above TIB statement) suggests that a unit trust is required to have more than one unit holder, this no longer represents the Commissioner's view. This interpretation statement sets out the Commissioner's view on this issue.

Analysis

16. Unit trusts are a type of trust. They can be set up at law and are not created by any legislation. However, there is legislation that applies to tax and regulate them. The commercial understanding of unit trusts is that they are a means for small investors to pool their funds to earn a potentially greater return than investing individually.

17. Unit trusts were first regulated in New Zealand with the enactment of the Unit Trusts Act 1960. Changes were made to the income tax legislation to explicitly provide for the treatment of unit trusts around the same time. The Act taxes unit trusts as companies rather than as trusts. Units are treated as shares and unit holders as shareholders.

18. This statement will consider three issues:

- whether a unit trust always needs more than one unit holder;
- whether a unit trust requires facilities for multiple unit holders or whether facilities for a single unit holder are sufficient (s 33 of the Interpretation Act 1999); and
- when a trust with a single unit holder will be a unit trust.

Whether a unit trust always needs more than one unit holder

19. If a unit trust is always required to have multiple unit holders, then a trust could never be a unit trust while it had only a single unit holder (whether permanently or at a particular point in time).

20. "Unit trust" is defined in s YA 1 as follows:

    unit trust—

    (a) means a scheme or arrangement that is made for the purpose or has the effect of providing facilities for subscribers, purchasers, or contributors to participate, as beneficiaries under a trust, in income and capital gains arising from the property that is subject to the trust; …

    For ease of reading, this statement will often just refer to "subscribers" as shorthand for "subscribers, purchasers or contributors".

21. Paragraph (b) of the definition contains a number of specific exclusions from the definition that are not relevant here.

22. There is nothing in the wording of the definition of "unit trust" that requires a unit trust to, in fact, have more than one unit holder. Rather, the trust scheme or arrangement must be "made for the purpose" or "have the effect" of **providing facilities** for subscribers (to participate as beneficiaries in income and gains from the trust property).

23. However, the portfolio investment entity (PIE) rules contain provisions that suggest that multiple unit holders may, in fact, be necessary to be a "unit trust" as defined. Section HM 3(1) relevantly states:

    HM 3 Foreign PIE equivalents

    General definition

    (1) A **foreign PIE equivalent** means an entity that—

    …

    (b) is—

    …

    (iii) the trustee of a trust that would be a unit trust if it had more than 1 subscriber, purchaser, or contributor participating as beneficiaries under the trust; and

    …

24. Similarly, s HM 9(c) relevantly states:

    HM 9 Collective schemes

    The entity must be—

    …

    (c) the trustee of a trust that would be a unit trust if there were more than 1 subscriber, purchaser, or contributor participating as beneficiaries under the trust:

25. The use of the phrase "that would be a unit trust if there were more than 1 subscriber, purchaser, or contributor" suggests that these sections were drafted based on the assumption that a unit trust must have two or more subscribers (rather than merely facilities for them).

26. Against this, it can be argued that an inference cannot be drawn about the definition of "unit trust" from the wording used in these other provisions. Arguably, the approach used in ss HM 3(1)(b)(iii) and HM 9(c) (with reference to subscribers) does not modify the definition of "unit trust". Rather, the sections could be read as asking for an assumption to be made as to the number of subscribers in the context of the PIE rules, with no bearing on the interpretation of the definition of "unit trust". This is particularly so, given that the words of the definition seem to be satisfied simply with facilities for many subscribers.

27. Another argument against inferring anything from these provisions is that, in drafting and enacting this legislation, it is likely Parliament and the drafters had in mind the Commissioner's published position in BR Pub 95/5A. If that is the case, not much can be drawn from these words about the correct interpretation of the definition of "unit trust". Case law has established that if Parliament makes a mistaken assumption about the law, this is not enough to make that interpretation the law – *IRC v Dowdall O'Mahoney & Co Ltd* [1952] AC 401 (HL), *Birmingham City Corp v West Midland Baptist (Trust) Association (Inc)* [1970] AC 874 (HL), and *West Coast ENT Incorporated v Buller Coal Ltd & Ors* [2013] NZSC 87.

28. In the Commissioner's view, these provisions in the PIE rules should not be read as suggesting that a unit trust is required to have multiple unit holders. A scheme or arrangement can be made for the purpose or have the effect of providing facilities for multiple subscribers to participate even where only one subscriber is currently participating. The circumstances where this is possible will be considered later.

Whether a unit trust requires facilities for multiple unit holders or whether facilities for a single unit holder are sufficient (s 33 of the Interpretation Act 1999)

29. The next issue that will be considered is whether s 33 of the Interpretation Act 1999 (the IA 99) means that a trust with facilities for only a single unit holder can be a unit trust. If s 33 applies in this way then a trust that can only ever have a single unit holder could still be a unit trust.

30. Section 4 of the IA 99 provides that the IA 99 applies to New Zealand acts unless the particular act provides otherwise, or unless the context otherwise requires (see also s AA 3(2) of the Income Tax Act 2007). Relevantly, s 33 of the IA 99 contains a rule concerning numbers (the numbers rule):

33 Numbers

Words in the singular include the plural and words in the plural include the singular.

31. Therefore, unless the context requires a different interpretation, words in the Income Tax Act in the singular include the plural and words in the plural include the singular.

32. The result of substituting the singular for the plural in para (a) of the definition of "unit trust" is as follows:

unit trust—

(a) means a scheme or arrangement that is made for the purpose or has the effect of providing [a facility] for [a subscriber], [purchaser], or [contributor] to participate, as [a beneficiary] under a trust, in income and capital gains arising from the property that is subject to the trust;

33. The issue is whether the context requires that the words in the plural in the definition not include the singular. The numbers rule is a useful drafting tool that assists the legislature to avoid cumbersome wording. However, the numbers rule does not always apply. It is, therefore, necessary to consider how case law has applied the numbers rule.

34. There are a number of cases that consider s 33 of the IA 99 and its international equivalents. The leading case is *Blue Metal Industries v Dilley* [1969] 3 All ER 437 (PC). Other cases include *Sin Poh Amalgamated (H.K) Ltd* [1965] 1 All ER 225 (PC), *Case F25* (1983) 6 NZTC 59,674, *Alliance Group Ltd v CIR* (1995) 17 NZTC 12,066 (HC), *CIR v Nicholson* [2005] NZFLR 385 (HC), *McDonald & Anor v Australian Guarantee Corporation (NZ) Ltd* [1990] 1 NZLR 227 (HC), *R v Cara* [2005] 1 NZLR 823 (HC), *R v K* [1995] 3 NZLR 159 (CA) and *Floor v Davis* [1979] 2 All ER 677 (HL).

35. The following principles can be drawn from the case law:

- The question is ultimately one of statutory interpretation – did Parliament intend for the words in a provision to be read in the singular or plural? Accordingly, the purpose of the provision, its text and its context in the enactment are all relevant.
- A contrary intention would appear if the application of the numbers rule would change the policy underlying the legislation.
- If there is a careful choice between the use of singular and plural expressions, that would suggest there is a contrary intention to reading words in the singular to include the plural (and vice versa).
- The effect of applying the numbers rule to the particular provision must be considered. If the application produces uncertainties in the provision's application, or suggests that the drafter would have drafted parts of the provision differently if the inclusion of the plural or singular had been intended, then this is evidence of a contrary intention.
- In considering whether the context requires departure from the numbers rule, a broad range of intrinsic and extrinsic material can be considered.

36. In summary, the case law on the numbers rule establishes that the rule applies in the present case if, when examining the purpose and context of the "unit trust" definition, we can conclude that Parliament would have intended to include the singular, but wanted to avoid cumbersome wording. If, however, the purpose of the legislation suggests that the use of the plural was deliberate, the numbers rule will not apply.

37. The scheme and purpose of the unit trust provisions are considered in greater detail below. However, a summary of the relevant points is set out here.

38. The "unit trust" definitions in the Income Tax Act and the Unit Trust Act were introduced in 1960 to deal with the practical matters around the regulation and operation (including tax) of unit trusts. In particular, the income tax rules were Parliament's response to pre-existing unit trusts, which were a form of trust that operated in New Zealand prior to the enactment of this law. It can be inferred that the definition chosen was designed to describe the essential attributes of such trusts.

39. As discussed in more detail later, the unit trust regime in the Income Tax Act was enacted to ensure that investors could not use unit trusts to avoid the two levels of taxation that were imposed on companies under the classical system of taxation (income tax was imposed at both the entity level and the investor level). At the time, the companies legislation required companies to have more than one shareholder.

40. In summary, a unit trust was widely understood as being a collective investment vehicle and it is reasonable to assume that the collective nature of such trusts was therefore intentionally reflected in their definitions. This is also supported by discussion in the *NZ Parliamentary Debates* at the time the Income Tax Act and Unit Trust Act provisions were being enacted. At the time, there were only four unit trusts in New Zealand and these were all widely-held investment vehicles.

41. Further, it is noted that there still appears to be a common view amongst commentators as to the purpose and features of unit trusts. For example, Edna Carew *The Language of Money* (George Allen & Unwin, Sydney, 1996) seems indicative of the material on this point. It states that a unit trust is structured to allow small investors to pool their money, which enables them to earn a greater return than if each investor had acted individually.

42. Given this it seems reasonable to conclude that the type of trusts Parliament was concerned with at the time of enactment of the unit trust legislation were collective investment vehicles, ie, multi-unit-holder trusts that had the attributes found in the definition. In short, trusts that, through their constituting documents, enable a group of investors (subscribers, purchasers, or contributors) to participate (as a group of beneficiaries) in the income and capital gains arising from the trust property. As a collective investment vehicle, it was usual for an initial subscriber to subscribe for a unit, which had the effect of settling trust property, and then for the unit trust manager to seek investments from either the public or private investors.

43. In the Commissioner's view, there is a significant practical difference between a trust with facilities for multiple investors to participate in the income and capital gains arising out of trust property and a trust where such a facility is restricted to a single investor (in the sense that the way it is set up only allows for a single investor). The unit trust provisions were clearly aimed at unit trusts with facilities for multiple investors. In the Commissioner's view, Parliament would not have contemplated or intended the "unit trust" definition to apply to a trust that was restricted to a single subscriber. Such a vehicle was not within the general understanding of a unit trust at the time. Nor would it have been a substitute for a company at the time (as companies required multiple shareholders).

44. Consequently, it is the Commissioner's view that the numbers rule does not apply to the "unit trust" definition. Therefore, a unit trust must provide facilities for multiple subscribers to meet the Income Tax Act definition. The circumstances where a unit trust will have such facilities are considered next.

When a trust with a single unit holder will be a unit trust

45. The following analysis will first consider the requirement that a "unit trust" be a "trust". It will then consider the meaning of "facilities", followed by the meaning of "subscribers, purchasers, or contributors". Lastly it will consider the meaning of "made for the purpose or has the effect". In particular, it will consider whether that phrase is satisfied by examining whether the legal relationships provide facilities for multiple unit holders, or whether there must also be an intention to have multiple unit holders.

Analysis of the words of the "unit trust" definition

Trust

46. There must be a "trust" for the definition of "unit trust" to apply. "Trust" is defined in s YA 1:

> **trust**, in the definitions of **superannuation scheme** and **unit trust**, has the meaning given by the Trustee Act 1956.

47. The definition of "trust" in the Trustee Act 1956 does not define a trust. Instead, the definition sets out specific inclusions and exclusions from the definition. Therefore, it is necessary to turn to the common law for the meaning of "trust". Greg Kelly and Chris Kelly in *Garrow and Kelly Law of Trusts and Trustees* (7th ed, LexisNexis, Wellington, 2013) define a "trust" at p 3 as follows:

> A trust is an equitable obligation under which a person (the 'trustee') has control of property but is bound to deal with that property either:
>
> (a) for the benefit of definite persons (that trustee may be one of them) and any one of them may enforce the obligation; or
>
> (b) for some object or purpose permitted by law.

48. There are four essential elements of a trust. There must be a trustee, trust property and a beneficiary, and the trustees must have an obligation to deal with the trust property for the benefit of the beneficiaries (see *Garrow and Kelly Law of Trusts and Trustees* at p 8).

Facilities

49. The *Oxford English Dictionary* (online ed, 3rd ed, Oxford University Press, accessed 22 January 2016) (OED) contains no separate entry for "facilities" but provides the following relevant definitions for "facility":

facility, n.

2.

a. Opportunity, esp. of an unlimited kind, to do something; capability, ability, provision; an instance of this. Also with for, of.

b. Freq. in pl. Favourable conditions or circumstances for the easy or easier performance of something. Also in sing., esp. in ***every facility***.

c. orig. U.S. In pl.: the physical means or equipment required for doing something, or the service provided by this; freq. with modifying word, as ***educational facilities, postal facilities, retail facilities***, etc. In sing.: a service or feature of a specified kind; (also) a building or establishment that provides such a service.

50. There do not seem to be any relevant cases on the meaning of "facilities". From the dictionary definition, the word "facilities" in the definition of "unit trust" might be said to refer to the provision of an opportunity or ability for subscribers to participate in the income and capital gains of the trust.

51. The definition of "unit trust" does not specify any particular requirements as to the form of the facilities. However, the Act gives some guidance as to what form is envisaged and, so, what facilities Parliament had in mind. The Act defines a "unit holder", for a "unit trust", as meaning "a person who holds a beneficial interest in the property that is subject to the trust" and defines a "share" to include "a unit in a unit trust". In the context of the meaning of "unit trust", for facilities to exist, a unit trust would be expected to provide a trust deed, trust property, a trustee and a trust manager. In addition, the beneficial interests in that trust property would be divided into units and those units would be able to be held by unit holders.

Subscribers, purchasers, or contributors

52. The Act does not define the words "subscribers", "purchasers", or "contributors". Therefore, they should each be given their ordinary meaning as interpreted in light of the context.

53. The *Concise Oxford Dictionary* (12th ed, Oxford University Press, New York, 2011) (COD) states that the word "subscriber" is the noun derivative of the word "subscribe" and provides the following (relevant) definition of the word "subscribe":

subscribe v. 1 (usu. **subscribe to**) … ■ contribute or undertake to contribute a sum of money to a project or cause ■ apply to participate in ■ apply for an issue of shares …

54. The OED (accessed 22 January 2016) provides the following relevant meanings of "subscriber":

subscriber n.

2.

a. A person who subscribes to a specified object or institution, the funds of a company, etc.

b. A contributor. Obs. nonce-use.

3.

a. A person who makes regular payment in return for entitlement to receive a periodical, membership of a society, access to a commercially provided service, etc.

55. "Subscriber" is, therefore, capable of different meanings. It can mean someone who has (or will) contribute money for something. It is also capable of a wider meaning such as a person who signs up or joins something, often, but not necessarily, for money.

56. Where courts are attempting to find definitions that reflect common usage in particular subject areas or sectors, they often refer to legal dictionaries. Legal dictionaries in the context of company and securities law show that the common commercial usage is the narrower one. That is a "subscriber" is a person that provides, or will provide, consideration. For example, see *Stroud's Judicial Dictionary of Words and Phrases* (8th ed, Sweet & Maxwell, UK, 2013) that states:

SUBSCRIBE. ... "Subscribe" very frequently means to pay money; and then it means (1) to have made an actual payment, or (2) to agree to contribute (T*hames Tunnel Co v Sheldon*, 6 B. & C. 341).

And *Black's Law Dictionary* (10th ed, Thomson West, USA, 2014) provides:

subscribe, vb. ... 10. To agree to buy or pay for (shares, stock, etc)

57. The Commissioner considers that the common commercial usage of "subscriber" is to be preferred in the context of unit trusts. The Act treats "unit trusts" as companies and unit holders as shareholders in a company. Therefore, applying the commonly understood meaning of "subscriber" in a company law context seems appropriate. Further, as discussed in more detail below, when Parliament enacted both the Unit Trusts Act 1960 and added the "unit trust" definition to the Income Tax Act, unit trusts were understood to be investment vehicles. An interpretation that requires "subscribers" to give consideration is consistent with this. This interpretation is also consistent with the meaning of the terms "purchaser" and "contributor", both of which require the giving of consideration (see below).

58. The COD states that the word "purchaser" is the noun derivative of the word "purchase" and provides the following (relevant) definition of the word "purchase":

purchase v. 1 buy (something) … **n. 1** the action of buying … ■ Law the acquisition of property by one's personal action rather than by inheritance.

59. The OED (accessed 22 January 2016) provides the following relevant meaning of "purchaser":

purchaser, n.

4. A person who purchases something with money (or an equivalent); a buyer. Now the usual sense. Also fig. and in extended use.

60. The OED (2nd ed) (accessed 22 January 2016) provides the following relevant definition of "contributor":

contributor, n.

a. One that contributes or gives to a common fund; one that bears part in effecting a result.

61. Having regard to the dictionary definitions, the words "subscribers, purchasers, or contributors" in the definition of "unit trust" are used in the sense of meaning a person who provides money (or its equivalent) in exchange for receiving something of value. While there are variations in the meaning of the three terms, a trust only needs to have facilities for one of the types to be within the "unit trust" definition.

62. The requirement for "subscribers", "purchasers", or "contributors" is one of the key differences between a standard trust and a unit trust. Unit trusts provide subscribers with a means to enter and exit the trust through the ability to buy and sell units that represent a share in trust property. That ability can be contrasted with trusts where the settlor determines the beneficiaries and those beneficiaries remain beneficiaries unless the trust comes to an end. The beneficiaries in a standard trust have limited ability to control the release of trust funds. Consequently, a discretionary trust will not be a "unit trust" even where the beneficiaries have settled property on the trust. In a "unit trust" it is the terms of the units that give unit holders the right to participate in income and capital gains arising from the trust property.

Made for the purpose or has the effect

63. The Act does not define the words "purpose" or "effect" or the expression "made for the purpose or has the effect".

64. The COD defines "made" as the past tense and past participle of "make". The verb "make" means:

2 bring about or perform; cause ■ cause to be, become or seem

65. "Purpose" is defined as:

The reason for which something is done or for which something exists.

66. "Effect" is relevantly defined as:

1 a change which is a result or consequence of an action or other cause.

67. The ordinary meaning of "purpose" can be interpreted as requiring an identification of the reasons why a unit trust is set up. This would include ascertaining the intention of those setting up the entity (and could include both objective and subjective considerations). This view is also supported by the use of the word "made". Grammatically, the sentence would make sense without the word "made", suggesting it was included for a purpose. Arguably, the word "made" alludes to the intention of those who set up or run the scheme or arrangement. Therefore, a scheme or arrangement "made for the purpose" of providing facilities for multiple investors is one where the reason for which the scheme or arrangement is undertaken is to provide facilities for multiple investors.

68. The ordinary meaning of "effect" is what has been achieved. Therefore, in the context of the meaning of the term "unit trust", a scheme or arrangement that results in the provision of facilities for multiple investors to participate in the income or capital gains arising from the trust property is a trust that has the required effect.

69. An alternative view is that "made for the purpose or has the effect" should be read as a composite phrase. This would be a purely objective test that looks at whether the requisite facilities exist. Support for this view can be found in case law on the words "purpose" and "effect" in another context. In New Zealand's tax avoidance jurisprudence, the meaning of the phrase "purpose or effect" and the approach to determining the "purpose or effect" of an arrangement is settled law. "Purpose", in the context of tax avoidance, means the intended effect the arrangement seeks to achieve and not the motive of the parties. The courts have distinguished between purpose and effect by referring to the purpose of the arrangement as the "**intended** effect" (*Ashton v CIR* (1975) 2 NZTC 61,030 (PC)) or the purpose as "the effect which [the arrangement] **sought** to achieve" (*Tayles v CIR* (1982) 5 NZTC 61,311 (CA)). "Effect" means the end accomplished or achieved by the arrangement. Although there are these subtle differences in meaning, in almost all cases the purpose and effect of an arrangement will be the same. The intended aim of the arrangement (the objective purpose), if successfully achieved, will be the arrangement's effect.

70. Tax avoidance cases on these words are clear that the purpose of an arrangement must be determined objectively. The subjective motives and purposes of the parties are irrelevant. An arrangement's purpose is determined by considering (objectively) the effect it has had – what it has achieved – and its effect must be taken to have been the arrangement's purpose. In *Glenharrow Holdings Ltd v CIR* [2008] NZSC 116, (2009) 24 NZTC 23,236, the Supreme Court said:

> [38] ...Once you put the purpose of the parties to one side and seek by objective examination to find the purpose of the arrangement, you must necessarily do that by considering the effect which the arrangement has had — what it has achieved — and then, by working backwards as it were from the effect, you are able to determine what objectively the arrangement must be taken to have had as its purpose.

71. The phrases "purpose or effect" and "made for the purpose or has the effect" are arguably materially indistinguishable. It is possible, therefore, that a court would construe the phrase "purpose or has the effect" in the definition of "unit trust" in the same way as it has construed the phrase "purpose or effect" in the definition of "tax avoidance arrangement". That is, it would do so by considering the objective features of the arrangement rather than the motivations of its participants.

72. In summary, the words "made for the purpose or has the effect" could be read as directing and confining the inquiry to the legal relationships entered into when the entity is established. Alternatively, they could be interpreted as requiring an examination of all the facts, including the intention of the settlor, trustees or managers. Avoidance law would potentially support the former approach. The two approaches are discussed in more detail below.

Legal relationships test – only objective evidence

73. This approach examines the legal relationships entered into, usually by looking at the establishing documents (and any other relevant documents) to see whether, objectively speaking, the entity provides facilities of the specified kind. A scheme or arrangement "made for the purpose" or "having the effect" of providing facilities for multiple subscribers is one where the scheme or arrangement is set up and undertaken, objectively speaking, to provide facilities for multiple subscribers to participate in the income or capital gains arising from the trust property.

74. When examining the tax treatment of a transaction, the first step is to ascertain the transaction's true nature (*Buckley & Young v CIR* (1978) 3 NZTC 61,271 (CA)). As was said in *Re Securitibank (No 2)* [1978] 2 NZLR 136 (CA), the true nature of a transaction can only be found by careful consideration of the legal arrangements actually entered into and carried out. In the case of a legal vehicle such as a unit trust, arguably this would generally be done by examining the documents that establish the unit trust. Therefore, determining whether the definition was satisfied would require an analysis of the scheme or arrangement to establish whether the legal rights and obligations created by it provide facilities of the necessary kind.

75. Under this approach, the relevant inquiry is not a factual one to determine whether, in practice, multiple persons are actually participating in the facilities provided. Therefore, an entity can be a unit trust within the definition if there is only one subscriber, provided there are facilities for multiple subscribers.

The test should take account of intention

76. The second approach looks not only at the legal relationships, but at all of the information available, particularly the intention of the settlor of the unit trust, and at what actually happens in practice. As discussed above, the use of the words "made for the purpose" arguably suggests that intention is relevant (although "effect" is less suggestive of intention).

77. This approach is based on the premise that the purpose or effect of a scheme or arrangement is not limited to the terms of the trust deed. Arguably, the effect of the scheme or arrangement is its result, outcome, or end product. In certain situations, the fact that the trust deed says it is possible for the trust to have multiple subscribers participating will not be enough to establish that the arrangement is made for the purpose of multiple subscribers participating. Nor will it be enough to establish that the arrangement has the effect of enabling multiple subscribers to participate. This will be the case if an overall assessment of the facts establishes that no such opportunity for multiple subscribers to participate is actually provided (or intended to be provided) by the scheme or arrangement.

78. Therefore, under this approach, if a scheme or arrangement provides the requisite facilities for multiple subscribers and the facts establish that the intention is to operate as a vehicle for multiple subscribers, the entity will be a "unit trust" within the definition even if there is only one unit holder.

Objective, intention and other factors

79. A variation on the second approach is one that takes all the facts into account and includes intention as just one of the factors in reaching a view. Both the second approach and its variation start from the position that a unit trust is, in most cases, an investment vehicle for many subscribers. However, both contemplate that there may be instances when, for whatever reason, there is only one subscriber. In such circumstances, a decision has to be reached whether the trust comes within the "unit trust" definition. A court might consider such unit trusts within the definition if having one unit holder was not a permanent feature. Factors a court might consider include whether there was the prospect of more unit holders, whether there had been more unit holders in the past, whether measures had been taken by the trustees or manager to secure more subscribers, and whether there were commercial reasons why, at a particular time, there was only one unit holder. The settlor's intention in setting up the unit trust could be relevant too, as well as how reasonably held that intention was.

Summary of analysis of the words of the "unit trust" definition

80. There is nothing in the wording of the "unit trust" definition to suggest whether a legal relationships test or an intention test (or a combination of both) should be preferred. As set out above, the wording can be read consistently with either approach.

81. Next this statement will consider the legislative history and context to try and determine the purpose of the unit trust regime.

Legislative history, context and purpose

82. Section 5 of the IA 99 requires the meaning of the text of an enactment to be ascertained in the light of its purpose. In determining purpose, both the immediate and general legislative context are considered, and it may also be relevant to consider the social, commercial, or other object of the statute (*Commerce Commission v Fonterra Co-Operative Group Ltd* [2007] NZSC 36). It is helpful to begin by examining the legislative history of the "unit trust" definition.

Introduction of the classical taxation system in 1958

83. The Land and Income Tax Act 1954 (LITA 54) came into force on 1 April 1955. Section 86(1)(i) provided that dividends were exempt income for individuals and companies.

84. Section 6 of the Land and Income Tax Amendment Act (No 2) 1958 amended s 86(1)(i) of the LITA 54 by removing the exemption for dividends derived by an individual. In short, s 6 of the 1958 Amendment Act introduced the classical tax system of company taxation. Under the classical system, a company is taxed on its income and individual shareholders are taxed on dividends received without reference to the tax paid at the company level on the same income.

85. The 1958 Amendment Act also introduced an excess retention tax. This was an anti-avoidance measure to counter companies retaining profits to avoid the dividend tax on individuals.

86. The introduction of the classical tax system for companies created a tax advantage for trusts and their beneficiaries because (unlike companies) they were taxed only once between them on the same income – either at the trustee or the beneficiary level (s 155 LITA 54).

Enactment of "unit trust" definition in 1960

87. The "unit trust" definition was inserted (as s 153B) into the LITA 54 in 1960 by s 20 of the Land and Income Tax Amendment Act 1960. As discussed below, the definition appears to originate from the definition of a "unit trust" in the Unit Trusts Act 1960. As originally enacted, the definition (in s 153B(1)) provided:

> "unit trust" means any scheme or arrangement, whether made before or after the commencement of this section, that is made for the purpose or has the effect of providing facilities for the participation, as beneficiaries under a trust, by subscribers or purchasers, in income and gains (whether in the nature of capital or income) arising from the money, investments, and other property that are for the time being subject to the trust; but does not include - …

88. Section 153B(2) of the LITA 54 provided (among other matters) that for the purposes of the LITA 54:
    - every unit trust shall be deemed a company and the term "company" where used in the LITA 54 shall be deemed to be extended accordingly;
    - the interests of the unit holders in the unit trust shall be deemed to be shares in the company;
    - the unit holders shall be deemed to be shareholders in the company.
89. Deeming a unit trust to be a company meant the following:
    - The assessable income of the unit trust was subject to classical taxation. The income of the unit trust was taxed at the level of the unit trust (as a deemed company) and then taxed at the unit holder (shareholder) level on payment of a distribution (dividend).
    - A unit trust was subject to the loss carry forward rule for companies in s 137(3). In summary, the rule provided that the Commissioner must be satisfied that the shareholders of the company on the last day of the year in which the loss was incurred were substantially the same as the shareholders on the last day of the income year immediately preceding the year of assessment. Substantially the same meant not less than two-thirds of the paid-up capital and not less than two-thirds of the nominal capital had to be held by the same persons.
    - The excess retention tax provisions applied to unit trusts.
90. It seems reasonable to infer that deeming a unit trust to be a company was directed at the mischief of subscribers using unit trusts to avoid the impost of tax at both the company and shareholder level.

Parliamentary debates – Land and Income Tax Amendment Bill 1960

91. In introducing the Land and Income Tax Amendment Bill 1960 to the Whole House, the Minister of Finance observed that unit trusts had just developed in New Zealand. It was, therefore, necessary to have a provision to deal with them and the proper way to do this was to treat them as companies – (7 September 1960) 324 NZPD 2156.
92. During the second reading, the Minister of Finance repeated that unit trusts had only come into operation in New Zealand earlier in the year (1960). He explained that it had been considered desirable to introduce legislation (the Unit Trusts Bill) dealing specifically with unit trusts to avoid some of the abuses that had arisen in connection with unit trusts in overseas countries – (7 October 1960) 324 NZPD 2846. The Minister then went on to explain the purpose of cl 20 of the Land and Income Tax Amendment Bill – (7 October 1960) 324 NZPD 2846:

    > This measure provides that unit trusts shall be treated as companies. Legislation has been passed in the United Kingdom this year providing that for taxation purposes unit trusts are to be treated as companies, the trustees are to be treated as directors, and the unit holders are to be treated as shareholders. Apparently they receive some allowance for management expenses without becoming liable for profits tax. Legislation [Unit Trusts Bill], as I have said, has already been introduced dealing with the general control of unit trusts. I would emphasise that this particular clause deals only with the taxation of these trusts, and in general the principle is that they will be treated as companies for the purpose of the law.

93. Opposition members were opposed to unit trusts being treated as companies. Their main reason was that interest income would be subject to classical taxation and this would discourage unit trusts from investing in Government stock and local body debentures and would result in unit trusts investing in company shares because of the inter-corporate dividend exemption.
94. It can be inferred from the Parliamentary debates that Parliament had a general understanding that unit trusts were similar to widely-held investment vehicles (ie, similar to public investment companies). The illustration of this is contained in a passage of the Hon J T Watts during the committee stage debate on the Unit Trusts Bill 1960, which Parliament was considering in parallel with the Land and Income Tax Amendment Bill 1960. That passage is set out at [103] below as part of the discussion of the Unit Trusts Act 1960.
95. It seems from the Parliamentary debates on the Land and Income Tax Amendment Bill 1960 that Parliament's primary concern was with the new development in New Zealand of the use of widely-held investment trusts. Parliament's purpose for the definition of a "unit trust" and the related provisions was for unit trusts to be taxed as companies rather than trusts. This was to ensure that unit trusts could not be used to avoid the double taxation of a company's

investment income under the classical system and was based on a perceived similarity between companies and unit trusts as investment vehicles. In particular, both unit trusts and companies involve the member providing money to the vehicle in return for an interest (ie, shares or units) in that vehicle's property and income.

Income Tax Act 1976 – amendments to the definition of "unit trust"

96. On enactment of the Income Tax Act 1976 (ITA 76), the definition of "unit trust" was in the same form as the LITA 54 definition.

97. From the income year commencing 1 April 1988, the definition was amended by s 22(1)(a) of the Income Tax Amendment Act (No 5) 1988 by substituting the words "subscribers, purchasers, or contributors" for the former words "subscribers or purchasers". The effect of the amendment was to expand the definition of "unit trust" to persons who were "contributors" to a unit trust.

98. The same amendment act inserted Part 4A (the foreign investment fund (FIF) regime) into the ITA 76. It seems that the intention behind expanding the definition of "unit trust" to include "contributors" was so that the FIF regime would apply to a person who contributed to a foreign unit trust where that unit trust was a superannuation scheme. The addition of the word "contributors" to the definition does not seem to shed any light on when a scheme or arrangement will meet the definition of "unit trust" and, in particular, whether the provision of the requisite facilities should be determined by legal relationships only or whether intention is relevant.

99. The imputation system was introduced with effect from 1 April 1988 and replaced the classical tax system of company taxation. The imputation system allows companies (including unit trusts) to pass the full benefit of tax paid at the company level on to shareholders (unit holders) with their dividends (distributions). The replacement of the classical system substantially reduced the difference between companies and (non-unit) trusts from a taxation point of view. Relevantly, the imputation system largely removed the tax advantage previously enjoyed by (non-unit) trusts under the classical system. This is because, imputation had the effect in broad terms, that a company and its shareholders are taxed only once between them.

100. However, there are differences in the tax treatment of trusts and companies, so there continues to be relevant purpose considerations in reaching a view on how unit trusts are taxed. For example, there may be a benefit in using a trust where the top personal tax rate is higher than the trust tax rate (as the tax on income from a trust can be capped at the trust rate), or where a person's marginal tax rate is lower than the company tax rate, or the person is exempt or in losses (due to the non-refundability of imputation credits). Some other rules in the Act also apply differently to trusts and companies.

101. Consequently, statutory purposes still exist in taxing unit trusts as companies rather than trusts post imputation, although these purposes are significantly less important than when the definition was introduced.

The enactment of the Unit Trusts Act 1960

102. As noted above, Parliament enacted the "unit trust" provisions into the LITA 54 in parallel with the enactment of the Unit Trusts Act 1960 (UTA 60). The Attorney General, in moving that the Unit Trusts Bill be committed to the Committee of the Whole House, explained that unit trusts were beginning to appear in New Zealand. He said that there was a positive duty on Parliament to take notice of the development and enact legislation to regulate unit trusts to protect the investing public from possible misconduct and unscrupulous or reckless management – (19 October 1960) 325 NZPD 3086–3088.

103. The comments of the Minister of Finance when introducing the Land and Income Tax Amendment Bill 1960 to the Whole House were referred to above. His comment was that unit trusts had just developed in New Zealand. During the committee stage debate on the Unit Trusts Bill 1960, the Hon J T Watts, the opposition member for Fendalton, said that he was personally interested in two unit trusts and explained that the drafting of the Bill had occurred over a 12 to 18 month period and that there were, at that time, four unit trusts in existence – (19 October 1960) 325 NZPD 3090:

> The New Zealand legislation has been carefully drawn over the last year or 18 months. I saw an early draft of the Bill and made some comments on it, and those interested in promoting unit trusts gave their representations to the Justice Department. As a result, I think we have a practical Bill for regulating the operation of this form of investment. There are at present four unit trusts in existence – two in Wellington, one in Auckland, and one in Christchurch. As the House knows, for I disclosed it when discussing the Land and Income Tax Amendment Bill, I am connected with the two unit trusts in Wellington, in which over £1 million has been invested. That sum has come in to those two trusts in the last four or five months, and there are about 8,000 to 9,000 different investors having that amount of money invested in industry in New Zealand and Australia through these two trusts.

Similarity of the definitions

104. The definition of "unit trust" in the LITA 54 is nearly identical to the definition of "unit trust" in the UTA 60. The one difference is that the UTA 60 definition requires that the scheme or arrangement have the purpose or effect of providing facilities for the participation by subscribers or purchasers as "members of the public". Under the Income Tax Act there is no reference to members of the public.

105. This distinction was noted in *Re Mortgage Management Ltd & Another* [1978] 1 NZLR 494 (SC) (the only reported New Zealand decision to consider the meaning of "unit trust" in the UTA 60). The court made some general comments about the definition of "unit trust", as well as a comment on the difference in wording between the UTA 60 definition and the definition for income tax purposes.

106. The relevant issue in that case was whether a contributory mortgage was a unit trust. The court observed, at 511, that the definition of "unit trust" in the UTA 60 had some resemblance to the definition of "unit trust" in the Prevention of Fraud (Investments) Act 1958 (UK). The UK Act defined "unit trust scheme" as:

> any arrangements made for the purpose, or having the effect, of providing facilities for the participation by persons, as beneficiaries under a trust, in profits or income arising from the acquisition, holding, management or disposal of securities or any other property whatsoever.

107. The court made comments in passing about the tax implications. It stated that an implication of being a unit trust was that it would be taxed as if it were a company. This comment implied the court considered that an entity that was a unit trust under the UTA 60 would also be a unit trust under the definition in the Land and Income Tax Act. Barker J said that the tax definition was wider. At 512, his Honour observed that the reason for the omission of the words "members of the public" from the definition of "unit trust" in s 153B of the LITA 54 was not clear. Barker J said that this difference in wording could mean that something that was not a "unit trust" under the UTA 60 might still be a "unit trust" for taxation purposes.

108. The difference in the definition can most likely be explained by the different purposes of the two Acts. The UTA 60 was enacted as a means to protect investors. Private unit trusts (that do not seek funds from the public) do not have the same risk to investors. On the other hand, the purpose of the Income Tax legislation treatment of unit trusts was to prevent tax avoidance opportunities that arose from using unit trusts instead of companies. It makes sense to include private unit trusts in this as the tax avoidance risk is as great (if not greater) than for public unit trusts.

109. For completeness, it is noted that the UTA 60 was repealed by the Financial Markets (Repeals and Amendments) Act 2013 (2013 No 70). Unit trusts will now be regulated by the Financial Markets Conduct Act 2013.

Current legislative context (the context of the Income Tax Act)

110. Unit trusts do not have their own regime in the Act. Therefore, few provisions concerned exclusively with unit trusts exist that can be analysed to assist in understanding Parliament's purpose. Instead, as already mentioned, unit trusts are included in the definition of "company", and so the rules applying to companies apply to unit trusts.

111. As noted above from [23], some provisions in the PIE rules suggest a trust must have multiple, actual unit holders, rather than mere facilities for unit holders. However, it has been concluded that the definition of "unit trust" does not require a trust to, in fact, have multiple unit holders.

112. In the Commissioner's view, nothing in the general legislative context assists with determining whether a legal relationships approach or an approach that takes account of intention should be preferred.

Purpose considerations – summary and conclusion

113. It appears that Parliament did not turn its mind to whether the provision of facilities for multiple subscribers should be tested solely by the legal relationships established/entered into or should also take account of intention. At the time, unit trusts were seen as large investment vehicles, so it is unlikely that a unit trust with a single unit holder was envisaged (except maybe when a new unit trust was starting up).

114. In considering the purpose of the legislation, it is relevant to identify any mischief Parliament intended to overcome by enacting the provisions. When originally enacted in 1960, the purpose of the definition was to prevent subscribers using unit trust structures (in the place of investment companies) to avoid the classical system of taxation that applied to companies.

115. An interpretation that looks only at legal relationships seems to be slightly more consistent with the anti-avoidance purpose of the "unit trust" definition at the time it was enacted. Also requiring evidence of a current intention to have

multiple unit holders would have made it easier to avoid the application of the company provisions. However, this is not a particularly strong indicator, especially given the lack of single unit holder unit trusts at the time.

116. In the Commissioner's view, the most helpful indicator of purpose in this context is the workability of the different interpretations. There is a presumption that Parliament intends to legislate in a manner that produces a practical, workable, and sensible result (*The Laws of New Zealand* Statutes (online ed, accessed 22 January 2016) at [177]). A statute must, if possible, be construed in the sense that makes it operative and that does not defeat the manifest intentions of the legislature. In cases where a provision may have several possible meanings, the courts look for the one that produces a practical result. Examples of cases where this presumption has been applied include *CIR v Alcan New Zealand Ltd* (1994) 16 NZTC 11,175 (CA); and *Frucor Beverages Ltd v Rio Beverages Ltd* [2001] 2 NZLR 604 (CA).

117. An interpretation that considers only legal relationships means that a unit trust that satisfies the test will always do so (barring any change to its trust deed). It is also easy to determine whether a trust provided facilities for multiple unit holders by looking at the legal arrangements.

118. On the other hand, intention can change over time. Therefore, an interpretation that takes account of intention could mean that a trust falls in and out of the unit trust regime as intentions change. It may also be difficult to determine whether the requisite intention exists at any given time – making the test potentially difficult to apply. It seems unlikely that this would have been Parliament's intention when enacting the provision.

119. The results seem even more likely to be outside Parliament's purpose when thinking about the tax consequences. A unit trust that no longer met the definition would forfeit any imputation credits and other company-specific tax entitlements. Further, it could result in a continuity loss, as the trust would no longer be looked through to its ultimate owners upon ceasing to be a unit trust. Such an outcome is arguably not sensible or workable.

120. Consequently, on balance, the Commissioner's view is that the purpose of the "unit trust" definition is most consistent with a legal relationships test.

Conclusion

121. This statement considers whether and when a unit trust can have a single unit holder. The conclusions reached are set out in the following paragraphs.

122. First, a unit trust does not need to, in fact, have multiple unit holders. Instead, a unit trust must only have **facilities** for multiple unit holders.

123. Second, the numbers rule in s 33 of the IA 99 does not apply. If the numbers rule applied, the plural elements of the definition of "unit trust" could be read as including the singular. This would mean that a trust that provided for only a single unit holder could be within the definition. However, in the Commissioner's view such an interpretation would be inconsistent with Parliament's purpose when it enacted the definition. Consequently, facilities for multiple unit holders are required for a trust to be a unit trust.

124. Finally, whether a trust provides facilities for multiple unit holders to invest should be determined by considering the legal relationships governing the trust – most importantly, the trust deed. Under this interpretation, the essential feature of a "unit trust" is the provision of the facilities for subscribers to participate, and that is not altered by there being only one subscriber.

Example

125. The following example is included to assist in explaining the application of the law.

Example: Trust deed provides for multiple unit holders

126. XYZ Ltd wanted to set up a unit trust that its employees could invest in. It sought expressions of interest from employees. Initially only one employee, Melvin, wished to invest. He subscribed for 10,000 units at $1 each. The XYZ Unit Trust was established by a trust deed between XYZ Ltd and the Trustee.

127. The trust deed provides that the trustee may from time to time issue additional units to any employee of XYZ Ltd – the cost of those units being calculated based on the value of the existing units at the date of application. Currently, Melvin remains the sole unit holder.

128. The XYZ Unit Trust is a "unit trust" for income tax purposes. The trust deed provides facilities for multiple subscribers to participate in the unit trust. The fact that there is currently only one investor does not matter.

References

Related rulings/statements

BR Pub 95/5A: "Relationship between the 'unit trust' and 'qualifying trust' definitions" *Tax Information Bulletin* Vol 8, No 10 (December 1996): 15

"Notice of non-renewal of public ruling BR Pub 95/5A" *Tax Information Bulletin* Vol 12, No 5 (May 2000): 4

Subject references

Income tax, unit trust

Legislative references

Income Tax Act 1976: s 211(1) definition of "unit trust"

Income Tax Act 2007: ss HM 3, HM 9, YA 1 definitions of "company", "trust", "unit holder", "unit trust"

Interpretation Act 1999: ss 4, 5, 33

Land and Income Tax Act 1954: ss 86(1)(i), 137, 153B

Unit Trusts Act 1960: s 2(1) definition of "unit trust"

Case references

Alliance Group Ltd v CIR (1995) 17 NZTC 12,066 (HC)

Ashton v CIR (1975) 2 NZTC 61,030 (PC)

Birmingham City Corp v West Midland Baptist (Trust) Association (Inc) [1970] AC 874 (HL)

Blue Metal Industries v Dilley [1969] 3 All ER 437 (PC)

Buckley & Young v CIR (1978) 3 NZTC 61,271 (CA)

Case F25 (1983) 6 NZTC 59,674

CIR v Alcan New Zealand Ltd (1994) 16 NZTC 11,175 (CA)

CIR v Nicholson [2005] NZFLR 385 (HC)

Commerce Commission v Fonterra Co-Operative Group Ltd [2007] NZSC 36

Floor v Davis [1979] 2 All ER 677 (HL)

Frucor Beverages Ltd v Rio Beverages Ltd [2001] 2 NZLR 604 (CA)

Glenharrow Holdings Ltd v CIR [2008] NZSC 116, (2009) 24 NZTC 23,236

IRC v Dowdall O'Mahoney & Co Ltd [1952] AC 401 (HL)

McDonald & Anor v Australian Guarantee Corporation (NZ) Ltd [1990] 1 NZLR 227 (HC)

R v Cara [2005] 1 NZLR 823 (HC)

R v K [1995] 3 NZLR 159 (CA)

Re *Mortgage Management Ltd & Another* [1978] 1 NZLR 494 (SC)

Re *Securitibank (No 2)* [1978] 2 NZLR 136 (CA)

Sin Poh Amalgamated (H.K) Ltd [1965] 1 All ER 225 (PC)

Tayles v CIR (1982) 5 NZTC 61,311 (CA)

West Coast ENT Incorporated v Buller Coal Ltd & Ors [2013] NZSC 87.

Other references

Concise Oxford Dictionary (12th ed, Oxford University Press, New York, 2011)

Edna Carew *The Language of Money* (George Allen & Unwin, Sydney, 1996)

Greg Kelly and Chris Kelly in *Garrow and Kelly Law of Trusts and Trustees* (7th ed, LexisNexis, Wellington, 2013)

The Laws of New Zealand Statutes (online ed) (7 September 1960) 324 NZPD 2156
(7 October 1960) 324 NZPD 2846
(19 October 1960) 325 NZPD 3086
(19 October 1960) 325 NZPD 3090

Oxford English Dictionary (online ed, 3rd ed, Oxford University Press)

APPENDIX – LEGISLATION

Income Tax Act 2007

1. Section YA 1 includes the following definitions:

company —

…

(b) includes a unit trust:

…

trust, in the definitions of **superannuation scheme** and **unit trust**, has the meaning given by the Trustee Act 1956

…

unit holder, for a unit trust, means a person who holds a beneficial interest in the property that is subject to the trust

unit trust —

(a) means a scheme or arrangement that is made for the purpose or has the effect of providing facilities for subscribers, purchasers, or contributors to participate, as beneficiaries under a trust, in income and capital gains arising from the property that is subject to the trust; and

(b) does not include—

(i) a trust for the benefit of debenture holders:

(ii) the Common Fund of Public Trust:

(iii) a group investment fund established by Public Trust:

(iv) the Common Fund of the Maori Trustee:

(v) a group investment fund established under the Trustee Companies Act 1967:

(vi) a friendly society registered under the Friendly Societies and Credit Unions Act 1982:

(vii) a superannuation fund:

(viii) an employee share purchase scheme:

(ix) a fund that meets the requirements of section CW 45 (Funeral trusts):

(x) any other trust of any specified kind that is declared by the Governor-General, by Order in Council, not to be a unit trust for the purposes of section HD 13 (Unit trusts)

Interpretation Act 1999

2. Section 4 provides:

4 Application

(1) This Act applies to an enactment that is part of the law of New Zealand and that is passed either before or after the commencement of this Act unless—

(a) the enactment provides otherwise; or

(b) the context of the enactment requires a different interpretation.

(2) The provisions of this Act also apply to the interpretation of this Act.

3. Section 5 provides:

5 Ascertaining meaning of legislation

(1) The meaning of an enactment must be ascertained from its text and in the light of its purpose.

(2) The matters that may be considered in ascertaining the meaning of an enactment include the indications provided in the enactment.

(3) Examples of those indications are preambles, the analysis, a table of contents, headings to Parts and sections, marginal notes, diagrams, graphics, examples and explanatory material, and the organisation and format of the enactment.

4. Section 33 provides:

33 Numbers

Words in the singular include the plural and words in the plural include the singular.

IS 16/02: – COMMISSIONER'S OPERATIONAL POSITION ON – UNIT TRUSTS – WHEN A UNIT TRUST CAN HAVE A SINGLE UNIT HOLDER

The Commissioner of Inland Revenue has released *Interpretation Statement* IS 16/02 "Unit Trusts – when a unit trust can have a single unit holder".

The view taken in this statement differs from the Commissioner's current published position set out in the commentary to BR Pub 95/5A: "Relationship between the 'unit trust' and 'qualifying trust' definitions" (which stated that to be a "unit trust" for income tax purposes requires more than one unit holder).

The Commissioner's view in *Interpretation Statement* IS 16/02 is:

- A unit trust does not need to have multiple unit holders. Instead, a unit trust only needs to have **facilities** for multiple unit holders.
- Whether a trust provides facilities for multiple unit holders to invest should be determined by considering the legal relationships governing the trust – most importantly, the trust deed. Under this interpretation, the essential feature of a "unit trust" is the provision of the facilities for subscribers to participate, and that is not altered by there being only one subscriber.

The Commissioner's view has changed from the previous view expressed in the commentary to BR Pub 95/5A where it stated that trusts who had only one unit holder did not meet the definition of "unit trust" for income tax purposes. The Commissioner will apply the following transitional operational position for those taxpayers that have been affected by the change in the Commissioner's position:

1. Trusts that have only one unit holder, but still have facilities in the trust deed for multiple unit holders and that have been applying the trust rules will have until 31 March 2018 to either:
   - Transition to applying the "unit trust" provisions; or
   - If they wish to continue being treated as a trust, amend their trust deed/documents to ensure they are not a "unit trust" (according to the principles set out in *Interpretation Statement* IS 16/02).
2. Trusts that have taken the view that there was a "unit trust" because the trust deed provided facilities for multiple unit holders, even though there was only a single unit holder are now in line with the Commissioner's view.

Trusts mentioned in [1] are still able to transition to the new position and/or amend their trust deed/documents to continue being treated as a trust for the year ended 31/03/2017 if they choose to do so.

Any taxpayers that have been adversely affected by relying on the Commissioner's previous position expressed in the commentary to BR Pub 95/5A, can contact Inland Revenue on 0800 443 773 to discuss the implementation of any changes in relation to *Interpretation Statement* IS 16/02.

Any new trusts however should apply the new position from the date of the publication of *Interpretation Statement* IS 16/02.

QUESTIONS WE'VE BEEN ASKED

This section of the *TIB* sets out the answers to some day-to-day questions people have asked. They are published here as they may be of general interest to readers.

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

This QWBA provides guidance about when proceeds from the disposal of land acquired with a purpose or intention of disposal are taxable under s CB 6 – one of the land taxing provisions. The QWBA explains how s CB 6 applies, and its relationship with the 2-year bright-line test (another land taxing provision). The QWBA also discusses some common misconceptions about s CB 6, and includes examples to illustrate when it will apply.

One of Inland Revenue's focuses is compliance with the land taxing provisions (including s CB 6 and the 2-year bright-line test), and as part of this work Inland Revenue conducts a range of activities to identify and address non-compliance with those rules. There is more information about the land taxing provisions and rules at **www.ird.govt.nz/property/** including a tool (the "property tax decision tree") to help you work out if any of the land provisions apply to you.

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. If I buy land for a purpose or with an intention of selling it, do the proceeds of the sale need to be included as income for tax purposes?

Answer

2. Yes. 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. As s CB 6 says, an amount that you derive on the disposal of land will be income 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 or intention. Disposal does not just mean sale; it also includes, for example, gifting or settling on trust.

5. There are two exclusions from this – for residential land and for business premises. 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 on sale if one of those exclusions (discussed further below at [7]) applies.

6. If s CB 6 does not apply, you may need to consider the other land provisions in the Act, including the 2-year bright-line test (see further from [8]). There are different exclusions depending on which of the land provisions is being considered, and they have different criteria. So you should not presume that because you can use an exclusion from one taxing provision other taxing provisions will also not apply. For example, you might potentially fall within the "residential exclusion" from s CB 6, but not within the "main home exclusion" from the 2-year bright-line test.

What are the exclusions from s CB 6?

7. As noted above, if you acquired land for a purpose or with an intention of disposing of it you will not be taxed under s CB 6 if you satisfy one of the two exclusions from that provision – for residential land (s CB 16) and for business premises (s CB 19). The requirements for those exclusions are set out below.

   Residential land exclusion from s CB 6

   Section CB 16 sets out the residential land exclusion from s CB 6. 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 under s CB 6 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.

   The house has to be acquired and occupied, or built and occupied, mainly as a residence. This means your occupation of the house cannot be incidental to another more significant purpose, eg, sale (see for example *Case G76* (1985) 7 NZTC 1,348, *Case K21* (1988) 10 NZTC 218 and *Case M102* (1990) 12 NZTC 2,634).

   To use this exclusion, the area of the land has to be 4,500 square metres or less, or if it is bigger, the larger area has to be required for the reasonable occupation and enjoyment of the house.

   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.

   Again, remember that this residential exclusion is different from the main home exclusion from the 2-year bright-line test, and has different requirements. The information published by Inland Revenue about how the main home exclusion from the bright-line test works is only relevant to considering that exclusion.

   Business premises exclusion from s CB 6

   Section CB 19 sets out the business premises exclusion from s CB 6. The exclusion will apply for business premises that you acquired and occupied or built and occupied mainly to carry on a substantial business from them. If the exclusion applies, you will not be taxed under s CB 6 on the proceeds from selling the property.

   A property mainly used for investment (eg, being rented out) is not premises acquired and occupied mainly to carry on substantial business from, so would not fall within the exclusion (see for example *Case D20* (1979) 4 NZTC 60,558).

   To use this exclusion, the land and the premises have to be reserved for the use of the business, and the area of the land can be no greater than that required for the reasonable occupation of the premises and the carrying on of the business.

   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.

   Remember that this exclusion has its own specific requirements. The information published by Inland Revenue about what "business premises" are for the bright-line test is only relevant to considering if the bright-line test applies.

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

8. The 2-year bright-line test came into force on 1 October 2015, and can potentially apply if you first acquired an estate or interest in land on or after that date (the normal rules about when you first have an interest in land will determine this).
9. The 2-year bright-line test may apply to tax any gains from residential land if you sell the land within two years of when you are treated as acquiring it for the purposes of this test. The 2-year bright-line test is **in addition** to the other land sale rules (including s CB 6) that have been in New Zealand's tax law for many years. It can apply if none of sections CB 6 – CB 12 apply.
10. Because the 2-year rule can only apply if none of sections CB 6 to CB 12 apply, you need to consider the application of those provisions first. If you acquired land for a purpose or with an intention of disposing of it and none of the exclusions apply, you will be taxed under s CB 6 rather than s CB 6A, even if the disposal is within two years.
11. If none of ss CB 6 – CB 12 apply, the 2-year bright-line test (s CB 6A) may tax any gains from residential property if the "bright-line date"[1] for your disposal is within two years of when you acquired the property. Your purpose or intention is not relevant to the 2-year bright-line test.
12. There are special rules about when you are treated as acquiring the land for the 2-year bright-line test, which differ from when you are treated as acquiring the land for the other land sale rules. In a typical land purchase situation, the

[1] This is the date you are essentially treated as disposing of the land for the purposes of the 2-year bright-line test. It is not usually the same date that you dispose of the land for the purposes of the other land sale rules. In a typical sale of land, it will be when you enter into a binding agreement to sell the land.

2-year period for the bright-line test will start when the title is registered to you. There are some exclusions from the 2-year bright-line test, including an exclusion for your main home.

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

13. 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]).

14. 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 evidence.
    - 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 also be relevant in testing what your subjective purpose or intention was when you acquired the land (eg, if these things contradict what you say your 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.
    - It is up to 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 purpose or intention was?

15. As noted above, it is your purpose or intention when you **acquired** the land that is relevant.

16. The rules in s CB 15B establish when you are treated as acquiring land for the purposes of the land provisions (except the 2-year bright-line test).[2] In a typical land sale, this will be when you enter into a binding contract to purchase the land, even if there are some conditions that need to be met.

    [The time of acquisition may be different in some circumstances, for example, if you acquired the land through exercising an option (s CB 15B(3)), or if a company obtains land under an agreement entered into before it was formed (s CB 15B(2)).]

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

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

18. However, if the Commissioner questions whether you acquired the land with a purpose or intention of disposal, you must be able to show that you did not. What you say your purpose or intention was will be assessed against all of the evidence. As to what evidence may be relevant, see from [34].

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

19. 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?

20. 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 discussed at [7]).

[2] These rules about when land is acquired apply for disposals of land on or after 22 November 2013.

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

21. As noted above, if you acquired the land with a purpose or intention of disposing of it, it does not matter if you rent it out in the meantime (whether because you always planned to rent the property out before selling it, or because you changed your mind and decided to rent the property out instead of selling it straight away). You will still be taxed on the proceeds when you eventually sell the land. This is the case even though the rental income will have been subject to tax. The rental income and any profit on the sale are both taxed under the Act (see s CC 1).

What if I only sell some of the land?

22. If you acquired the land with a purpose or intention of disposing of it, 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).

23. If you divide land, there are other provisions that could also be relevant to whether you are taxed on the disposal of the land – for example s CB 12 (Disposal: Schemes for development or division begun within 10 years) or s CB 13 (Disposal: Amount from major development or division and not already in income).

What if I buy some land intending to subdivide it and sell some and keep some?

24. If you acquire land intending to sell some and keep some, you will only be taxed on the disposal of the part you acquired to sell. You would need to have satisfactory evidence to show how much of the land or what part of the land you did not acquire for a purpose or with an intention of disposal. (See for example: *Bedford Investments Limited v CIR* [1955] NZLR 978 (SC), *Harkness v CIR* (1975) 2 NZTC 61,017 (SC) and *Church v CIR* (1992) 14 NZTC 9,196 (HC).)

What if I buy the land through a trust, company or partnership?

25. Section CB 6 can apply regardless of whether the property is acquired by an individual person or an entity such as a trust, partnership 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. (See for example: *CIR v National Distributors Ltd* (1989) 11 NZTC 6,346 (CA), *Trustees of the B Trust v C of IR* [2013] NZTRA 5, *FC of T v Whitfords Beach Pty Ltd* 82 ATC 4031 (HCAFC), *Allied Pastoral Holdings Pty Ltd v FC of T* 83 ATC 4015 (SCNSW), and *Aotea Group Securities Ltd v C of IR* (1986) 8 NZTC 5,052 (HC).) If the owner is a partnership, it is the purpose of the partnership that is relevant. (See s HG 2(1) and *CIR v Boanas* (2008) 23 NZTC 22,046 (HC).)

Does s CB 6 only apply to sales of freehold land?

26. 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 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). However, the expiry of an interest in land is not a disposal – for example the expiry of a lease or the expiry of an option.

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

27. No. Property cannot be gifted (this includes settling it on a trust) 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).

What if I did not buy the land, or if I got it from someone I was associated with?

28. If you received the land passively, eg, by way of gift, you would generally not be taxed under s CB 6, because you would not have acquired it with a purpose or intention of disposal (see for example *A G Healing and Co Ltd v CIR* [1964] NZLR 222 (SC) and *McClelland v FCT* (1970) 120 CLR 487 (PC)). However, you might be taxed on the disposal of land you received passively from someone you were associated with.

29. If you obtain land (passively or otherwise) from someone you are associated with, you may potentially be taxed under s CB 6 (or one of the other land provisions) when you dispose of it. This may be the case if the person you acquired the land from would have been taxed under s CB 6 if they had kept the land and disposed of it when you did (see s CB 15). The person you acquired the land from may already have been taxed under s CB 6 when they transferred the land to you. But you would also be potentially subject to tax under s CB 6 on the difference between your cost base for the land and what you derive when you dispose of it.

30. You may also be taxed under s CB 6 on a similar basis in other circumstances – for example if you received the land under a relationship property agreement and the transferor is subject to tax under s CB 6, or from a deceased person's estate if the person would have been subject to tax under s CB 6.

31. There are also special rules that might apply if you received the land by way of a distribution from a company (s FC 1), or if an amalgamated company receives it as part of certain amalgamations (s FO 17).

Can I get any tax deductions?

32. 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, to the extent that those costs are incurred in deriving the income 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).

[There is a different timing rule for deductions for the cost of revenue account property that ceases to exist (s EA 2). So, for example, if you had a revenue account leasehold interest or option and it expired or (in the case of an option) was exercised, you may still get a deduction even though the land may not have been disposed of – see further QB 15/13.]

33. You may also be able to deduct other expenditure, such as interest on money borrowed to purchase the land, insurance premiums, and repairs and maintenance costs (to the extent those costs are not capital). Deductions for these expenses will be allowed to the extent that they are incurred in deriving the income and are not private in nature (ss DA 1, DA 2 and DB 6).

What evidence would be relevant to show that I did not have a purpose or intention of disposal when I acquired the land?

34. Any evidence that shows you did not have a purpose or intention of disposing of the land when you acquired it will be considered. For example, records about why you acquired the property made by the financial institution that provided finance for the purchase or by the real estate agent, proof of a change in your circumstances that led to the sale, minutes of board meetings, resolutions of directors or trustees, or anything else that shows what your purposes or intentions in acquiring the property were.

35. Remember that if s CB 6 applies, it does not matter when you sell the property. So you should keep any relevant documentary evidence about what your purpose or intention in acquiring property was, even beyond the normal seven-year timeframe for keeping tax records.

Other taxing provisions that could apply if s CB 6 does not

36. If s CB 6 (see from [13]) does not apply to you, there are a number of other land sale rules in the Act that may tax you on the sale proceeds. The other provisions you might be taxed under could apply 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 the improvements were begun you were (or were associated with someone who was) in the business of erecting buildings (s CB 11);
- 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);
- the land was used as landfill (s CB 8);
- you dispose of the land within 10 years of acquiring it and 20% or more of the increase in its value arises from any of various factors such as a change to the rules of a district plan, the granting of a consent, or a decision of the Environment Court under the Resource Management Act 1991 (s CB 14);[3]
- you received the land from someone you were associated with (s CB 15); or
- none of sections CB 6 – CB 12 apply, the land is residential land, and the "bright-line date" for your disposal of the land is within two years of when you acquired it (s CB 6A).[4]

[3] See s CB 14(2) for the full list of factors.

[4] "Residential land" is defined in s YA 1. As noted above, for the purposes of this rule (known as the 2-year bright-line test), the 2-year period generally does not start at the date you acquire land for the purposes of the other land provisions in the Act. In a standard purchase of land situation, the 2-year period will start on the date the land transfer is registered to you. The "bright-line date" for a disposal of land is typically the date you enter into an agreement for the disposal, but may be different in different circumstances (see s CB 6A(7)).

37. 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?

38. 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, you should discuss the matter with your tax advisor, or Inland Revenue, and consider making a voluntary disclosure.

Examples

39. The following examples are included to assist in explaining the application of s CB 6, and are aimed at dispelling common misconceptions that Inland Revenue encounters in its property compliance activity. 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. The examples do not consider whether any of the other land sale rules in the Act apply.

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

40. 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.

41. For the purposes of s CB 6, Tabitha and Jono acquired the land on 10 September 2015, when they entered into the sale and purchase agreement to buy the property. At that time, their intention was for the house to be their family home. It does not matter that by 25 September 2015, when their purchase of the property was settled, they intended to dispose of it, and indeed had already entered into a sale and purchase agreement to do so. It was only because of an attractive, unsolicited offer that Tabitha and Jono changed their minds about living in the property and decided to dispose of it instead. At the date they acquired the property (10 September 2015), they did not intend to dispose of it. The extent of commitments made or steps taken shortly after land is acquired may be relevant in testing what someone's purpose or intention was. In this case, if Tabitha and Jono can provide evidence that the offer was unsolicited, the fact that they entered into a contract to sell the land shortly after they entered into the contract to buy it is not inconsistent with their stated purpose at the time they entered into the contract to buy the land.

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

43. It is presumed that none of sections CB 7 to CB 12 apply.

44. The 2-year bright-line test does not apply to Tabitha and Jono's sale of the land, because they first acquired an estate or interest in it before 1 October 2015.[5]

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

45. 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.

46. 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.

47. 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.

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

[5] Section 4(2) of the Taxation (Bright-line Test for Residential Land) Act 2015.

49. 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.
50. 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.
51. 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.
52. Laura and Connor are also allowed deductions for 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 that are not capital in nature.

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

As noted above, the examples in this QWBA do not consider whether any of the land sale rules other than s CB 6 apply. More specifically, it is noted that this example is not considering whether Taj is carrying on a business relating to land, so s CB 7 is not considered.

53. Taj acquired 10 properties over a 10-year period – all before 1 October 2015. Eight 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 eight 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.
54. However, all of the eight 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. Three of the properties were held for less than six months. After each of the eight 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.
55. 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 evidence.
56. In this case, Taj's explanations for each of the sales are not supported by the evidence 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 (for a brief period) from two of the properties. The explanations for each of the sales are not supported by the evidence – including for the properties that were briefly rented out. 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. Taj must be able to show that he did not acquire each of the properties with a purpose or intention of disposing of them, and he has not done this.
57. Neither the residential exclusion (s CB 16) nor the business exclusion (s CB 19) apply to any of the properties, because Taj did not live in any of them or carry on a business from any of them.
58. Therefore, the Commissioner considers that the proceeds on the sales of the eight properties in question are income to Taj under s CB 6.
59. 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.
60. Taj is also allowed deductions for 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 that are not capital in nature.

Example 4 – It is for the taxpayer to show that land was not acquired with a purpose or intention of disposal

61. 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 indefinitely once they came to New Zealand. 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.

62. If the Commissioner forms the view that you acquired the land with a purpose or intention of disposal, it is up to you to show that you did not.

63. 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.

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

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

66. 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.

67. Hugh and Meg are also allowed deductions for 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 that are not capital in nature.

Example 5 – More than one purpose or intention

68. 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 expected to be able to realise the capital gain he sought to make on the property. Chris has paid tax on the rental income. He sold the property in October 2015 for a sizeable profit.

69. 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.

70. The suggestion in the marketing material that the property was expected to have great annual capital growth and could be rented out in the meantime does not determine Chris's purpose or intention in buying the property. However, Chris acknowledges that he purchased the property with a short-medium term investment horizon in mind, after which he anticipated selling it to realise the capital gain he expected to make.

71. 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, though it was to be rented out in the interim.

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

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

74. 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.

75. Chris can get a deduction against the sale proceeds for the amount he paid to acquire the property and for the cost of any capital improvements he made to the property.

76. Chris is also allowed deductions for 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 that are not capital in nature.

References

Related rulings/statements
QB 15/13 "Income tax Whether the cost of acquiring an option to acquire revenue account land is deductible" *Tax Information Bulletin* Vol 28, No 1 (February 2016)
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 8, CB 9, CB 10, CB 11, CB 12, CB 13, CB 14, CB 15, CB 15B, CB 16, CB 19, CB 23B, CC 1, DA 1, DB 6, DB 7, DB 23, EA 2, FC 1, FC 2, FO 17, HG 2(1) and the definition of "residential land" in s YA 1 Taxation (Bright-line Test for Residential Land) Act 2015 – s 4(2)
Case references
Allied Pastoral Holdings Pty Ltd v FC of T 83 ATC 4015 (SCNSW) *Aotea Group Securities Ltd v C of IR* (1986) 8 NZTC 5,052 (HC) *Anzamco Ltd (in liq) v CIR* (1983) 6 NZTC 61,522 (HC) *Bedford Investments Limited v CIR* [1955] NZLR 978 (SC) *Case D20* (1979) 4 NZTC 60,558 *Case G76* (1985) 7 NZTC 1,348 *Case K21* (1988) 10 NZTC 218 *Case M102* (1990) 12 NZTC 2,634 *Case N59* (1991) 13 NZTC 3,457 *Case Y3* (2007) 23 NZTC 13,028 *Church v CIR* (1992) 14 NZTC 9,196 (HC) *CIR v Boanas* (2008) 23 NZTC 22,046 (HC) *CIR v National Distributors Ltd* (1989) 11 NZTC 6,346 (CA) *FC of T v Whitfords Beach Pty Ltd* 82 ATC 4031 (HCAFC) *Harkness v CIR* (1975) 2 NZTC 61,017 (SC) *Jurgens & Doyle v CIR* (1990) 12 NZTC 7,074 (HC) *Trustees of the B Trust v C of IR* [2013] NZTRA 5

LEGAL DECISIONS – CASE NOTES

This section of the *TIB* sets out brief notes of recent tax decisions made by the Taxation Review Authority, the High Court, Court of Appeal, and the Supreme Court.

We've given full references to each case, including the citation details where it has already been reported. Details of the relevant Act and section will help you to quickly identify the legislation at issue. Short case summaries and keywords deliver the bare essentials for busy readers. The notes also outline the principal facts and grounds for the decision.

These case reviews do not set out Inland Revenue policy, nor do they represent our attitude to the decision. These are purely brief factual reviews of decisions for the general interest of our readers.

STRIKE OUT APPLICATION DISMISSED

Case	TRA 030/15 [2016] NZTRA 06
Decision date	13 July 2016
Act(s)	Tax Administration Act 1994: ss 14, 89AB, 89K and 138H
Keywords	Service, strike out, disputes process

Summary

The Taxation Review Authority ("TRA") dismissed the Commissioner of Inland Revenue's ("the Commissioner") strike out application as service of the notices of assessment did not appear to be satisfactory and issues as to the disputant's standing to bring proceedings needed to be canvassed.

Impact

The decision highlights the necessity for the Commissioner to ensure compliance with s 14(8) of the Tax Administration Act 1994 ("TAA") when issuing notices of assessment by post.

Facts

The Commissioner applied to strike out the disputant's challenge proceedings on the basis that the claim had no reasonable cause of action as the disputant had not complied with the requirements of the disputes process. The disputant opposed the application and argued that there was no evidence of his assessments before the TRA.

On 17 February 2011, the disputant was adjudicated bankrupt following a previous investigation by the Commissioner. In 2013 the disputant was charged with, and subsequently pleaded guilty to, various offences of failing to file income tax returns with the intention of evading the assessment or payment of tax and tax evasion.

In December 2013, the Commissioner made a number of default assessments and subsequently issued notices of assessment to the disputant. Notices of assessment for the majority of the relevant periods/income years were sent to the Official Assignee at a Private Bag address in March 2014.

Further copies of the notices of assessments were issued to the disputant in March and April 2014. The disputant did not take any steps and consequently on 1 August 2014 the Commissioner wrote to the disputant advising that he was deemed to have accepted the assessments.

Judgment was subsequently entered against the disputant in June 2015 for the debt. On 25 September 2015 the disputant issued a notice of proposed adjustment ("NOPA") to the Commissioner. The disputant alleged that no notice of disputable decision had been issued and no assessments had been made. The Commissioner replied on 28 September 2015, repeating her advice that as the disputant had not supplied a NOPA and the requisite tax returns within the required period, the assessments were now deemed to be accepted.

On 2 October 2015 the disputant again corresponded with the Commissioner, attaching a further copy of his NOPA. The Commissioner responded on 29 October 2015, informing the disputant that the Commissioner had considered whether his late NOPA could be accepted however had determined that the requirements of s 89K of the TAA had not been met. The disputant subsequently issued challenge proceedings.

Decision

Although acknowledging there were considerable difficulties with the disputant's claim, the TRA was not prepared to grant the Commissioner's application to strike out the proceeding.

The Commissioner had submitted that the disputant had not complied with the requirements of the disputes process in Part 4A of the TAA which precede the right to challenge under Part 8A. In particular, the Commissioner contended the disputant had failed to file a NOPA within the applicable response period; had not satisfied the requirements under s 89K; and had failed to file the outstanding returns as required by s 89D.

However, the TRA was not satisfied on the evidence before it that any of the notices of assessment were properly served on the Official Assignee in accordance with s 14(8) of the TAA as no evidence was provided to show the address was the current address for the Official Assignee and/or that the notices were addressed to the Official Assignee.

The Commissioner did concede that the notices of assessments for two GST periods were not sent to the Official Assignee and therefore the response period in s 89AB of the TAA had not been triggered and so any challenge under Part 8A of the TAA in respect of those assessments was premature.

The Commissioner also contended that the disputant had no standing to bring or continue the proceedings as the assessments related to property acquired by the disputant during the period of his bankruptcy as the property vested in the Official Assignee and the disputant's rights in it were extinguished.

The TRA noted that while the Commissioner made this submission, the Commissioner had still proceeded against the disputant in his personal capacity and obtained judgment against him in respect of the relevant assessments.

DECISION REINFORCES STRENGTH OF SECTION 81 PROVISIONS

Case	FAF Holdings Limited (in liq) and Ors v R J Bethune CIV 2015-412-0080 [2016] NZHC 1595
Decision date	14 July 2016
Act(s)	S 81 Tax Administration Act 1994
Keywords	Liquidations, discovery obligations, secrecy provisions, s81 Tax Administration Act 1994, Companies Act 1993

Summary

The High Court found that due to s81(3) of the Tax Administration Act 1994 ("TAA"), the Commissioner of Inland Revenue ("the Commissioner") is not required to comply with discovery obligations under r 8.25 of the High Court Rules. Associate Judge Christiansen stated that due to the secrecy provisions invoked in s81(3), disclosing was not necessary for carrying into effect the Revenue Acts. His Honour further noted that the proceeding was between liquidators (governed by the Companies Act 1993) and Mr Bethune, the director of FAF Holdings Ltd ("the Company"), thus the tax liability of the company was not in dispute.

Impact

This judgment upholds the long-standing principle that the Commissioner does not have to comply with information requests or discovery orders from parties who are not entitled to that information under any of the exceptions to secrecy in s 81.

Facts

FAF Holdings Limited was put into liquidation on an application from the Commissioner on 11 December 2014.

The liquidators, who are the second respondents in these proceedings, are suing Mr Bethune, sole director and shareholder of the company, for a number of alleged breaches of director's duties under the Companies Act 1993.

Mr Bethune denies that he breached these duties and says in his defence that he was unaware that the company had difficulties until December 2013 and that it was an in-house accountant who had control and responsibility of the company's finances.

The liquidators requested from the Commissioner the company's files. These were provided by the Commissioner and duly discovered to Mr Bethune. The liquidators filed an affidavit stating that they had fully discovered to Mr Bethune all relevant documents obtained from the Commissioner. Mr Bethune, however, contended that there were exchanges between himself and Inland Revenue that were not part of the discovered documents.

To further his defence, Mr Bethune applied for non-party discovery against the Commissioner, seeking (inter alia) correspondence, internal reports and file notes on the company's solvency and potential claims by the Commissioner against Mr Bethune.

The Commissioner opposed the application under section 81(3) TAA. Pursuant to that section, no officer of the Department shall be required to produce in any Court or Tribunal any document or to devolve or communicate to any Court or Tribunal any matter or thing coming under the officer's notice in the performance of the officer's duties as an officer of the Department, except when it is necessary for carrying into effect the Revenue Acts, the listed accident compensation legislation, any other act imposing taxes or duties payable to the Crown or Commissioner's powers, duties or functions under the New Zealand Superannuation Act 1974.

The Commissioner also submitted that Mr Bethune was not entitled to the company's information under s 81(4)(l) (information held or obtained in relation to that person or their representative) because directors cease to have powers, duties or functions (other than those permitted under the liquidation provisions of the Companies Act) once a company is placed into liquidation.

Decision

Associate Judge Christiansen dismissed the application. His Honour held that s 81(3) applied as disclosing was not necessary for carrying into effect the Revenue Acts.

His Honour also held that due to the privilege in s 81(3), the Commissioner is not required to comply with discovery obligations under the High Court Rules.

The fact that the Commissioner had lodged the claim resulting in the company's liquidation was irrelevant; the tax liability of the company is not in dispute. The proceeding is between the liquidators, who have duties under the Companies Act which is not a Revenue Act, and Mr Bethune. Accordingly, the Commissioner is not required to produce the documents for the purpose of carrying into effect the Revenue Acts.

Mr Bethune did not have standing to request the company's documents under the exception in s 81(4)(l), therefore the section does not authorise the Commissioner to provide the company's information to Mr Bethune.

Costs were awarded on a 2B basis plus disbursements as approved by the Registrar.

LEGAL DECISIONS - CASE IMPACT STATEMENTS

CAPITAL-REVENUE EXPENDITURE: DEDUCTIBLE FEASIBILITY EXPENDITURE

Case	Trustpower Ltd v Commissioner of Inland Revenue [2016] NZSC 91
Decision date	27 July 2016
Act(s)	Income Tax Act 2004, Tax Administration Act 1994
Keywords	Sections DA 1, DA2, DB 13B, DB 19, OB 1, EE 6, EE 7, EE 53, Schedule 17, 138G, IS 08/02, feasibility, commitment, resource consents, capital, revenue, deductibility, black hole, sufficient connections

Summary

The Supreme Court disagreed with the Court of Appeal that the general permission in s DA 1 of the Income Tax Act 2004 was not satisfied in relation to expenditure Trustpower made in obtaining resource consents for possible future generation projects, and held that the expenditure was incurred in the course of carrying on its business as a generator and retailer of electricity for the purpose of deriving assessable income.

The Court determined that any expenditure (feasibility in nature or otherwise) addressed to a capital project will generally be on capital account and non-deductible. The Court did not accept the taxpayer's argument that all feasibility expenditure incurred prior to commitment to obtain a capital asset or enduring benefit (feasibility expenditure) will be deductible. However, expenditure associated with early stage feasibility assessment, that is a normal incident of business, may be deductible, particularly where it is not directed toward a specific project. The Supreme Court's approach is different in some important respects to that taken in the Commissioner's Interpretation Statement *Deductibility of Feasibility Expenditure* (IS 08/02).

Case impact statement

The Supreme Court approach represents the current legal position, and must be applied by the Commissioner and taxpayers from the date of judgment. Accordingly, the Commissioner will be applying the principles in the Supreme Court's decision in relation to any binding ruling applications, and in any future challenges, and so tax positions taken after the date of the judgment should take the decision into account. However, the Commissioner will not be actively reviewing previous years where taxpayers have applied the Interpretation Statement approach.

The Commissioner is currently reviewing her Interpretation Statement in light of the judgment, and intends to issue a revised version of the statement for public consultation in due course. The Supreme Court decision should be referred to for guidance until any amended Interpretation Statement is issued.

REGULAR CONTRIBUTORS TO THE TIB

Office of the Chief Tax Counsel

The Office of the Chief Tax Counsel (OCTC) produces a number of statements and rulings, such as interpretation statements, binding public rulings and determinations, aimed at explaining how tax law affects taxpayers and their agents. The OCTC also contributes to the "Questions we've been asked" and "Your opportunity to comment" sections where taxpayers and their agents can comment on proposed statements and rulings.

Legal and Technical Services

Legal and Technical Services contribute the standard practice statements which describe how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical operational issues arising out of the administration of the Inland Revenue Acts. They also produce determinations on standard costs and amortisation or depreciation rates for fixed life property used to produce income, as well as other statements on operational practice related to topical tax matters.

Legal and Technical Services also contribute to the "Your opportunity to comment" section.

Policy and Strategy

Policy advises the Government on all aspects of tax policy and on social policy measures that interact with the tax system. They contribute information about new legislation and policy issues as well as Orders in Council.

Litigation Management

Litigation Management manages all disputed tax litigation and associated challenges to Inland Revenue's investigative and assessment process including declaratory judgment and judicial review litigation. They contribute the legal decisions and case notes on recent tax decisions made by the Taxation Review Authority and the courts.

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