NEW ZEALAND INSTITUTE OF CHARTERED ACCOUNTANTS

5 March 2010

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Dear Graham

Brochure on property purchased "off the plans"

The New Zealand Institute of Chartered Accounts ("the Institute") received a copy of the Inland Revenue Department ("the Department") brochure IR 368, which was forwarded to Stephen Rutherford. We consider the brochure is not legally correct, and that the brochure should not have been issued. The Institute strongly supports the Department publishing its views. However, we consider that the position taken is so out of kilter with current case law, and the brochure would encourage people to pay tax where no tax is due.

Summary
In summary, we consider that:

1. The issue of when land is acquired under section CB 6 of the Act is a matter of statutory interpretation.
2. The time that the purpose or intention is determined is at the time that the land is acquired.
3. The definition of "land" includes an estate in land, whether legal or equitable, vested or contingent.
4. Where a person holds an option to acquire land that is also defined as "land" and accordingly the holding of an option to acquire land is the holding of "land".
5. An option is also a type of equitable interest that can be held in property.
6. Where a person agrees to purchase property under a conditional contract of sale, the Court of Appeal in *Bevan v Smith* found that where a contract is a condition subsequent, then an equitable interest will pass to the purchaser.
7. Under the standard conveyancing agreements used for domestic properties in New Zealand, the agreements are drafted as a condition subsequent. Accordingly under those

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agreements, a taxpayer will acquire a contingent beneficial interest in the property upon the signing of the standard form agreement, even if the contract is conditional.

8. Therefore, a taxpayer who has acquired an interest under a conditional contract to purchase land using a standard form ADLS agreement or Real Estate Institute of New Zealand agreement, should have their intention to resell the property assessed at the time at which they signed the agreement (i.e. not when the condition in the agreement becomes unconditional).
9. We disagree with Inland Revenue's view that the intention should be assessed at the time when the condition in a conditional agreement is fulfilled, as that reasoning is based on the *Mills Case* which was considering a different issue – i.e. whether there had been a "sale or other disposition" had been made - this is a completely different issue to whether a person has acquired any estate or interest in land whether legal or equitable, or whether vested or contingent, in possession, reversion or remainder. The Judge in that case noted that:
    a. the legislature had chosen the expression "sale made" and not "contract entered into".
    b. In the *Mills Case* that both counsel accepted that it was the contract that was the relevant document to consider, as opposed to the option or notice of election in the *Beetham Case* (i.e. which had considered the statutory interpretation of the meaning of the word "acquired").

   It seems ironic that the *Mills Case* that Inland Revenue relies on has already distinguished itself from the statutory interpretation that Inland Revenue is seeking to draw from it. In *Beetham's Case* Henry J cautioned against using the meaning of "acquired" in section 116 of the Land Act 1948 and applying it to section 88(1)(c) of the Income Tax Act 1954. Inland Revenue has gone one step further and taken the meaning of "acquired" in section CB 6 of the Act from different words altogether. Henry J went on to say that the word "acquired" was a very wide term which was used in respect of every type of property or interest in property. He felt that it was not for the Court to substitute other words for those used by the Legislature in an attempt to give a definition. In our view, the legislation has been clarified since that time by more clearly defining the types of interest covered by the meaning of the term "land" and "estate or interest" in land. Further other cases such as *West, AG Healing* and *Morgan v Beck and Pope* provide strong support for that view.
10. We accept that the position regarding options is not exactly the same as that arising under a conditional contract. However, these are both contingent beneficial interests and are a clear reflection of what was intended under the statutory language. Given the close legal nature of an option, an irrevocable offer and a contract with a contingent condition, it would be anomalous if these were to be treated differently under section CB 6 of the Act. Similarly, the Court of Appeal in *Walker's Case* (idem) held that timing of determining when person is liable to tax under a scheme is when the scheme or undertaking is devised[1].

[1] See also *Gilmour v C of IR* [1968] NZLR 136

We set out the reasons for our views in the attached appendix

If there are any matters which you wish to discuss, please contact me on (04) 4600 395.

Yours sincerely

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cc Martin Smith

Appendix

Background

We were not consulted on the brochure – in fact we only received a finalised copy of the brochure on the 24th of November 2009 when it was being issued on the 30th of November 2009. As we were not consulted, we were not privy to any underlying analysis of the reasons for that view. Having made enquiries, we understand it is based upon some cases that went through Adjudication – these dealt with section CD 1(2)(a) of the Income Tax Act 1994 and they turned on whether land was acquired with the intention of resale.

Further, in those cases which we have seen, the Commissioner was arguing that *Mills v CIR* (1985) 7 NZTC 5,025 is authority for the proposition that, under a conditional contract, acquisition of land occurs when beneficial ownership of the land is passed. In the *Mills Case* (idem), the taxpayer had 11 blocks of land to sell, the sale of which was conditional upon the scheme plan of subdivision being deposited before 1 December 1973. After the conditional contracts had been signed, the law was amended which would apply to the sale of properties "derived from any sale or other disposition made on or after the 10th day of August 1973." The subdivisional plan was deposited before 1 December 1973, but not before 10th of August 1973. The taxpayer argued that the sale had occurred prior to the 10th of August 1973. However, the court held that it was only when the contract was unconditional that there was a "sale made".

In the *Mills Case* (supra) the court was considering whether "any sale or other disposition" had been made, whereas under section CB 6 of the Act, the issue is whether a taxpayer acquired the land for 1 or more purposes or intentions, one of which was the purpose or intention of disposing the land. In our view, there are numerous fundamental differences between the *Mills* situation and issues raised in the current brochure. We will discuss these in greater detail shortly but for example:

- In the *Mills Case* the taxpayer was the vendor, whereas in the situation in the brochure, the taxpayer's actions that are under consideration are those when the taxpayer acquires the land.

- There is a fundamental difference in the wording of the provisions to be considered. In the *Mills Case* issue was whether there was a "sale or other disposition", whereas in the brochure situation the issue is whether the taxpayer "acquired the land" with a purpose or intention of resale.

The point from this is that Adjudications seems to assume that they can apply the same test to two completely different situations that have a different statutory test. Are the differences important? For example, in the case of a sale, there needs to be consideration moving from one party to another. In the case of an acquisition, there can be no consideration moving one side of the transaction – for example the term "acquire" can refer to nothing more than receiving something. In the case of *Congreve and Congreve v IRC* [1946] 2 All ER 170, 183, Wrottesly J said "*As used by lawyers, the word 'acquired' has long covered transactions of a purely passive nature and means little more than receiving.*" See also *McClelland v FC of T* [1971] 1 All ER 969, *Re Payne* [1968] QSR 287 and *Halliwell v CIR* (1991) 13 NZTC 8,197, *Harkness v C of IR* (1975) 2 NZTC 61,017.

In addition to this, the use of the term "acquired", plus the statutory definitions of the words "land" and "estate" means that is possible to receive a lesser interest in the land, well before the land is sold.

We will now consider the statutory definitions of "land" and "estate", as in our view, the central issue regarding the sale of property 'off the plans' is directly dealt with by the wording of the statute.

Statutory Interpretation

The primary task that should be undertaken in this instance, is the construction of the statute which Parliament used to impose the tax[2]. The relevant parts of the legislation are as follows:

Legislation

Section CB 6 of the Act provides:

> *"CB 6(1) INCOME*
> *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."*

The first question is "when" does a taxpayer acquire the land? The term "land" is defined in section YA 1 of the Act as follows:

> *"land —*
> *(a) includes any estate or interest in land:*
> ***(b) includes an option to acquire land or an estate or interest in land:***
> *(c) does not include a mortgage:*
> *(d) is defined in section CB 19(3) (Business exclusion from sections CB 6 to CB 11) for the purposes of that section:*
> *(e) is defined in section IZ 1(12) (Use of specified activity net losses) for the purposes of that section:"*
> (Emphasis added)

Further, the term "estate" is also defined in section YA 1 as follows:

> *"estate, for land,—*
> *(a) means an estate in the land, whether legal or equitable, and whether vested or contingent, in possession, reversion, or remainder; and*
> *(b) includes a right, whether direct or through a trustee or otherwise, to—*
> *(i) the possession of the land:*
> *(ii) the receipt of the rents or profits from the land:*

[2] Refer Westmoreland Investments Ltd v MacNiven [2001] BTC 44 in which Lord Hoffman said: "There is ultimately only one principle of construction, namely to ascertain what Parliament meant by using the language of the statute. All other 'principles of construction' can be no more than guides which past judges which past judges have put forward, some more helpful or insightful than others, to assist in the task of interpretation."

(iii) the proceeds of the disposal of the land; and
(c) does not include a mortgage "

Principles of interpretation to be applied
The basic principles of statutory interpretation in New Zealand are set out by *Mangin v CIR* [1971] NZLR 591 and *CIR v Alcan New Zealand Ltd* (1994) 16 NZTC 11,175 (CA). In the course of giving judgment for the majority Lord Donovan said [1971] NZLR at p 594:

> *"Its [s 108's] history will be outlined presently; but it may be useful to recall at the outset some of the rules of interpretation which fall to be applied.*
>
> *First, the words are to be given their ordinary meaning. They are not to be given some other meaning simply because their object is to frustrate legitimate tax avoidance devices. As Turner J. says in his (albeit dissenting) judgment in Marx v CIR (1970) N.Z.L.R. at p. 208, moral precepts are not applicable to the interpretation of Revenue Statutes.*
>
> *Secondly, 'one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used' [per Rowlatt J. in Cape Brandy Syndicate v I.R. Commrs. (1921) 1 K.B. 64 at p. 71, approved by Viscount Simons L.C. in Canadian Eagle Oil Co. Ltd. v R. (1946) A.C. 119].*
>
> *Thirdly, the object of the construction of a statute being to ascertain the will of the legislature it may be presumed that neither injustice nor absurdity was intended. If therefore a literal interpretation would produce such a result, and the language admits of an interpretation which would avoid it, then such an interpretation may be adopted.*
>
> *Fourthly, the history of an enactment and the reasons which led to its being passed may be used as an aid to its construction."*

The Court of Appeal considered Lord Donovan's statements in *CIR v Alcan New Zealand Ltd* (idem). In delivering the Court's judgment, McKay J stated:

> *"The first proposition of Lord Donovan, in the passage cited from the Privy Council in Mangin's case, is that words are to be given their ordinary meaning. This is fundamental to all statutory interpretation. There must be a strong and sufficient reason before words can be given some other meaning which they are capable of bearing in a particular context. If the object of a tax statute is to frustrate tax avoidance devices which would otherwise be legitimate, that alone may not be enough. If, however, the words are capable of more than one meaning and the object of the legislation is clear, then the words must be given 'such fair, large and liberal construction' as will best ensure the attainment of the object of the Act.*
>
> *The statements by Lord Donovan (including his citation from Turner J) that moral precepts are not applicable to revenue statutes, and that there is no room for intendment, no equity about a tax, no presumption, must be similarly understood. In the complex economic world of the present day it is perhaps inevitable that anomalies can be found in our tax laws. The statements referred to sound a note of caution against too readily assuming that the legislation has a particular objective which the words of the statute must be made to fit. Not*

infrequently the particular purpose is unclear. Parliament may have tolerated anomalies in the interests of avoiding excessive complexity. In such cases the safest guide to meaning will be found in the actual words of the statute. As was said by Richardson J in C of IR v Challenge Corporation Ltd (1986) 8 NZTC 5,001 at p 5,020:

'That is a matter of statutory construction and the twin pillars on which the approach to statutes mandated by sec 5(j) of the Acts Interpretation Act 1924 rests are the scheme of the legislation and the relevant objectives of the legislation. Consideration of the scheme of the legislation requires a careful reading in its historical context of the whole statute, analysing its structure and examining the relationships between the various provisions and recognising any discernible themes and patterns and underlying policy considerations.

Certainly the scheme and the purpose approach to statutory analysis will not furnish an automatic easy answer to these interpretation problems. Tax legislation reflects historical compromises and it bears the hands of many draftsmen in the numerous amendments made over the years. It is obviously fallacious to assume that revenue legislation has a totally coherent scheme, that it follows a completely consistent pattern, and that all its objectives are readily discernible.'

Application of principles of interpretation to legislation

Under these principles, the words of the statute are given their ordinary meaning, and the meaning of the statute is what a court would have regard to in deciding whether a particular taxpayer is subject to tax.

Based on these provisions, a person acquires land when they (inter alia) acquire an estate in land that is either legal or equitable, or whether it is vested or contingent. Clearly a person who has a legal interest in land would be subject to section CB 6 of the Act. The earliest time at which a person might have either an "option" or an "estate" in land is where the definition is at its widest. For example, it is more likely that a taxpayer will subject to section CB 6 if the taxpayer had a contingent equitable interest in land. So what is meant by a contingent equitable estate in the land?

Accordingly, what is the ordinary meaning of the words used? What is an estate in the land?

The *Shorter Oxford English Dictionary (5th ed 2002)* describes an estate as:

"III (A piece of) land; property
10. Property, possessions, fortune, capital. Arch ME b The collective assets and liabilities of a person, esp. one deceased or bankrupt. M19.
11. Law. The interest that a person has in land or other property. LME"
12. A landed property, esp a large one. M18…….".

The word "estate" is of very broad import and can have a wide range of meanings. However, in this context, the possible meanings that "estate" can have is considerably narrowed.

The section refers to "*an estate in the land, whether legal or equitable, and whether vested or contingent, in possession, reversion, or remainder."* In this context, it is submitted that the ordinary meaning of the words used is not the appropriate meaning to be considered. That is, the term "estate" in the eleventh definition corresponds to the context in which the actual word "estate" is used in the definition – which is the law or legal definition. It is suggested that it is the legal definition that is used in these circumstances as it is used in a legal context. i.e. if the words are used in a legal context, then the legal meaning of those words is the appropriate meaning to use[3]. Further, the term "land" is referring to a singular piece of land, whereas the word "estate" refers to "an estate in the land". So this reflects a partial interest in the land. Based on that, an estate can be a partial interest in the land, rather than just the land itself. This is consistent with the way that the Doctrine of Estates was adumbrated in Walsingham's Case (1573) 2 Plowd. 547:

> *"Wyat had the land, but the land itself is one thing, and the estate in the land is another thing, for an estate in the land is a time in the land, or land for a time, and there are diversities of estates, which are no more than diversities of time, for he who has a fee-simple in land has a time in the land without end, or the land for time without end, and he who has land in tail has a time in the land or the land for time as long as he has issue of his body, and he who has an estate in land for life has no time in it longer than for his own life, and so of him who has an estate in land for the life of another, or for years."*

Similarly in *New Zealand Land Law*[4] it states:

> *"Since each estate has a different duration, several estates can exist simultaneously over the same piece of land physical land. These are called concurrent estates."*

In summary the use of the word "estate" as a partial interest in land reflects the legal meaning of the word "estate". This is the case for the following reasons:

- The context of the word "estate" refers to "*an estate in the land, whether legal or equitable"* which suggests that the estate is a partial interest in the land.
- The juxtaposition of the words, "*whether legal or equitable*" in reference to "*estate*" demonstrates that the words are being used in a legal context.
- This is consistent with the surrounding words such as, *legal, equitable, vested, contingent, in possession, reversion, and remainder* which also give it a legal context.
- The use of the term "estate" in a legal context refers to a partial interest in land.

[3] Refer Statutory Interpretation; A Code FAR Bennion 5th ed 2008 page 1199. Section 366 "If a word or phrase has a technical meaning in a certain branch of law, and is used in a context dealing with that branch, it is to be given that meaning, unless the contrary intention appears" and the authorities cited for that proposition.
[4] Refer New Zealand Land Law – Bennion, Brown, Thomas & Toomey published Brookers 2005 para 1.5

What is the meaning of the word "equitable"? The word "equitable" has two meanings"[5]:

> *"1 Characterized by equity or fairness, just. Now chiefly of actions, arrangements etc M16.*
> *2.LAW Pertaining to equity; (of a right, claim etc) valid or recognised in equity as opp to common law. M17."*
> *[Examples]*
> *1. Gathorne-Hardy How can it be equitable to exclude some of them from the benefits?. 2. Times Equitable mortgagees of a house in ….Hackney.*

When used in this context, the word "equitable" also has a legal meaning of being an interest that is recognised in equity, as opposed to an interest that is recognised in common law. This is again because the context in this word appears, indicates that the word in used in a legal sense, i.e. it refers to "*estate in the land, whether legal or equitable, and whether vested or contingent, in possession, reversion, or remainder."* This is further supported by the context which juxtaposes the "*estate in land"* being either "*legal or equitable".* That juxtaposition eliminates the possibility that it is referring to the alternative meaning of "fairness".

Similarly the word "contingent" is also used in a legal context, so it would also take its legal meaning. The Shorter Oxford English Dictionary describes this as[6]:

> *"Dependent on a forseen probability; provisionally liable to exist or take effect."*

This corresponds with the meaning in *Stroud's Judicial Dictionary* which refers to[7]:

> *"Anything is "contingent" when it is liable to failure on the happening or non-happening of an event, condition or state of things."*

The statutory test used in section CB 6 is whether a person acquires a legal or equitable interest, whether that estate is vested or contingent. So what would constitute a contingent equitable estate in land?

A contingent equitable estate in land can arise in a variety of ways. For example, where a person has an option over land, prior to the exercise of the option, the grantee owns a contingent equitable interest in the land[8].

However, given our current context of "off the plan" sales – how is this most likely to occur? Under an unconditional agreement for sale and purchase, a purchaser receives a beneficial or equitable estate upon the signing of the agreement for sale and purchase. For example, in *Lysaght v Edwards* (1876) 2 Ch D 499 the court held:

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[5] Refer Shorter Oxford English Dictionary 5th ed 2002
[6] Refer Shorter Oxford English Dictionary 5th ed 2002
[7] See Stroud's Judicial Dictionary of Words and Phrases 6th ed 2000 Sweet & Maxwell page 510.
[8] See for example *Laws of New Zealand – Sale of Land* by DF Dugdale & Justice Chambers page 4 Para 3 and also the authorities cited there – *Morland v Hales* (1910) 30 NZLR 201, *Buyn v Ogg* [1967] NZLR 279.

> *"The moment you have a valid contract for the sale the vendor becomes in equity a trustee for the purchaser of the estate sold and the beneficial ownership passes to the purchaser.*

Where a conditional agreement for sale and purchase occurs, then this position is qualified. The position in New Zealand up to 1994, was that a conditional purchaser did not obtain an equitable estate, see *Concept Projects Ltd v Peak and Robertson* (1986) 2 NZCPR 468; *Assocs Group Motels No. 1 Ltd v Steen* 15/6/94 Master Anne Gambrill HC Auckland M367/94. These cases were based on two propositions:

- Where there is an unconditional agreement which is enforceable by specific performance, the equitable interest in the land passes to the purchaser; but
- Specific performance of a conditional agreement will not be granted until the conditions have been fulfilled or waived, and accordingly prima facie a conditional purchaser does not obtain the equitable estate.

This position was reversed by the Court of Appeal in *Bevin v Smith* [1994] 3 NZLR 648. As *Brookers Land Law* describes[9]:

> *"The Court accepted the desirability of a purchaser under a conditional contract being able to protect his or her interest by way of caveat, and that, as a matter of practicality, parties to a contract which is defeasible on failure of a condition of the kind complained of in this case are in essentially the same position as parties to an unconditional contract pending completion. The Court felt that an equitable interest in the land should and does pass under a conditional contract of the kind involved in this instance, even though specific performance of the contract in the strict sense was not available. The Court agreed with the Australian judgment [Kuper v Keywest Construction Pty Ltd (1990) 3 WAR 419] that the equitable estate passes when equity will, by injunction or otherwise, prevent the vendor from dealing with the property inconsistently with the purchaser's contingent ownership rights.*
>
> *However, the Court did stress that whether an equitable interest has passed must always depend on the terms of the contract itself. Where the contract is subject to a true condition precedent, and where the parties cannot be regarded as intending that equitable title is to pass to the purchaser until the condition is either waived or fulfilled, the equitable title will not pass."*

Brookers Land Law then records the development of the case law after the *Bevin v Smith Decision* (idem). The first case to consider *Bevin v Smith* was the High Court's decision in *McDonald v Issac Construction Co Ltd* [1995] 3 NZLR 612. There the Court noted (at page 619):

> *"The nature of the condition may be important. If it is such that until fulfilment it can be said that the parties did not intend to create any interest in land there will be no caveatable interest unless and until the condition is fulfilled. But, in the usual case where the parties intend to be bound and to remain bound subject to the fulfilment of the condition, equitable interests in land can arise by means of such a conditional contract."*

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[9] Refer *Brookers Land Law* – Loose leaf series at paragraph 2.7.07 20 November 2008

The reasons why the High Court referred to the "usual case", became apparent in subsequent cases. In New Zealand, the majority of residential property transactions use a standard conveyancing agreement issued by the Real Estate Institute of New Zealand and the Auckland District Law Society. That standard agreement makes it clear that, unless it is expressly provided otherwise, any conditions under the agreement for sale and purchase are conditions subsequent. As such, pending satisfaction of the conditions specified (i.e. and assuming that the vendor and purchaser have not specified any conditions precedent) then there is a binding agreement for the sale of the land per the agreement for sale and purchase. Accordingly, unless the conditions subsequent fail, the parties have a binding agreement from the date that they sign the contract. The effect of the ADLS agreement was noted by Master Sargisson in *Southern Cross Finance Ltd v Lee* 20/12/02 HC Auckland M979-IM02. He said:

> *"Since the condition is a condition subsequent it is clear that a binding contract came into being when it was signed and thus an equitable estate passes to the Lees, although specific performance is contingent upon all the conditions subsequent being waived or fulfilled."*

The same result occurred again in *Abis Properties Ltd v Orion NZ Ltd* (2004) 5 NZCPR 881 (HC) where Hansen J said:

> *"Since Bevin v Smith it is beyond doubt that a purchaser under a conditional agreement for sale and purchase has an equitable interest capable of supporting a caveat. However, there is a dispute between counsel as to what type of condition supports a caveatable interest. It is clear from McDonald v Issac Construction Ltd that the terms of the agreement are paramount as to whether or not a caveatable interest exists."*

Brookers Land Law note that where there is an intention to use the property for subsequent development, then it is typical for there to be a large list of conditions with the requirement that all conditions having to be satisfied to the entire satisfaction of just one of the parties. This issue was raised in *Diplomat Apartments Ltd v Cook Island Property Group (NZ) Ltd* 21/9/06 HC Wellington CIV 2006-485-1312.

In summary, where a contract is conditional under a standard ADLS agreement, then the contract is cast as a condition subsequent and the parties will have binding agreement, even though the conditions have not yet been fulfilled. Where the conditions are standard and are normally found in a contract of this type, then in these conditional contracts, the purchaser has an equitable interest in the land.

Parliament has provided that if an estate is an equitable contingent estate, then it is "land" for the purpose of section CB 6. The question then becomes at what time did the purchaser acquire that equitable contingent interest? The Courts have held that they acquire that interest (when the agreement is a standard ADLS agreement (i.e. a condition subsequent)) when the agreement for sale and purchase is signed.

Accordingly, the key question is what is the intention or purpose of the purchaser at the time at which they acquired that equitable estate. If, when they acquired the property, they had an intention or purpose of resale, then the taxpayer will be subject to section CB 6 of the Act.

Why do we disagree with Inland Revenue's view?

We disagree with Inland Revenue's view for a number of reasons. Based on an Adjudication Report and a separate taxpayer Statement of Position that we have sighted, Adjudication has based their analysis upon the *Mills Case.* The reasoning given in the Adjudication report was as follows:

> *"Mills is relevant to the meaning of 'acquired', because the issue was framed as follows:*
>
> > *'The legislature has chosen the expression 'sale made' and not 'contract entered into'. But neither counsel was able to refer to any authority defining when a 'sale' is 'made'. Mr Bates, however, did not argue that it was only upon settlement. Both counsel saw the contract as the relevant document (cf Beetham v C of IR 72 ATC 6042 in which Henry J held that land was 'acquired' by a lessee on the day of delivery of a notice of intention to exercise his right to purchase the fee simple, for that had the effect of creating a binding contract. If the purchaser had 'acquired' the land that day, the vendor must be taken to have sold it contemporaneously).'"*

There are a number of reasons why we disagree with this view:

1. In *Mills* the issue (as the Judge noted[10]) was whether there was a "sale made" not whether there was a "contract entered into". This is a different statutory question than whether a person "acquired" an estate in the land". Presumably Parliament used different words because it intended there should be a different outcome. It is therefore not appropriate to use one case as authority for interpreting a word where different statutory words are being used.
2. In the passage cited from the *Mills Case*, the judge is contrasting the situation between the *Mills* facts and *Beetham's Case*[11]. In the *Mills* facts, both counsel saw the contract as the relevant document to be considered. This was contrasted with the facts in *Beetham's Case* (idem) where the taxpayer had "acquired" land by giving notice of his intention to exercise his right to purchase the fee simple of the said land. This notice was given on 8 May 1953, and on 29 October 1953, the Commissioner of Crown Lands gave the taxpayer a notice under the Land Act 1948 which informed him of the price that he would have to pay. The taxpayer then had the option of paying a cash price or on a deferred payment license over a period of thirty years. So in *Beetham's Case* the taxpayer was some distance away from a "sale made" when he was considered to have "acquired" land for the purposes of section 88(1)(c) of the Land and Income Tax Act 1954. However, in the *Mills Case* both counsel agreed that it the relevant document to be considered was the contract (i.e. not the notice of intention to exercise the right to purchase the fee simple). It seems ironic that the case that Inland Revenue relies on has already distinguished itself from the statutory interpretation that Inland Revenue is seeking to draw from it.
3. In as far as the Judge Hardie-Boys in the *Mills Case* states:

[10] Refer *Mills v CIR* (1985) 7 NZTC 5,025 at page 5,026.
[11] Refer *Beetham v CIR* [1973] 1 NZLR 575.

"If the purchaser had "acquired" the land that day, the vendor must be taken to have sold it contemporaneously."

a) That expression is dicta.
b) That cannot be an expression of law that is intended to have general application – for example in *Halliwell v C of IR (1991) 13 NZTC 8,197* the taxpayers acquired land passively through a will. So who "sold" the land in that case?
c) As noted above, the term "acquired" is far broader in that it has been treated as being equivalent to "receiving". So in as far as there is a suggested analogy that where someone acquires something, someone else would have sold it, the analogy is incorrect.
d) The *Mills Case* was based on a legal analysis of land law that has now been overruled by the Court of Appeal. For example, Hardie-Boys J states[12]:

   Whilst a contract is still conditional, the purchaser cannot call for the legal estate and cannot sue for specific performance in order to obtain it. It follows that the equitable estate remains in the vendor."

   The statement that equitable estate remains in the vendor is now clearly wrong following the Court of Appeal's decision in *Bevan v Smith* (supra) as discussed above.
e) In the *Mills Case* (supra), the court was considering whether the profits were "*derived from any sale or other disposition made on or after the 10th day of August 1973*". The word "derived" connotes the source or origin rather than the fund or place from which the income was taken, and means flowing, springing, or emanating from, or accruing[13]. Further the term "derived" means more than merely received. As the Department notes[14]:

   "*It is settled law that the timing of derivation and the method of accounting "should be that which is calculated to give a substantially correct reflex of the taxpayer's true income". (C of T(SA) v The Executor Trustee and Agency Company of South Australia Limited (Carden's Case) (1938) 63 CLR 108;"*

   Accordingly if you attempted to record peoples income when a contract was only conditional – it would not be a "correct reflection" of their income, as there is not a sufficient degree of certainty that income will arise from that contract. For example, the timing of derivation of income from land was held to be not when the contract was unconditional, but rather when a debt could be collected[15]. This can be distinguished from the section CB 6 situation, where the taxpayer has purchased the property and the legislation is looking back to the time at which the now vendor acquired their interest in the property. If the person who is now the

[12] Refer *Mills v CIR* (1985) 7 NZTC 5,025 5,028.
[13] Refer CIR v Philips (NV) Gloeilampenfabrieken [1955] NZLR 868;
[14] Refer Trading Stock – Tax treatment of sales and agreements to sell BR Pub 04/06
[15] Refer *Gasparin v FCT* 94 ATC 4280.

vendor acquired an interest in the property with the intention or purpose of resale, then Parliament has determined that the income that the taxpayer makes from that sale is subject to tax.

What is the correct time at which the test of acquisition should be applied from a Policy Perspective?

There are two competing views as to when the test should be applied. The Adjudication Report referred to *Molloy on Income Tax* – A P Molloy 1976 Volume 3. Dr Molloy sets out his views as follows:

"**[406] Moment of Acquisition**

The instant at which the requisite purpose or intention was present, for the purposes of the first category; the instant at which a taxpayer was in business, for the purposes of the second and third categories; and the commencement of the 10 year period during which a scheme will be vulnerable to the fourth category: are questions to be decided as at the moment of acquisition of the land which has been disposed of. In respect of the second, third and fourth categories, and where the disponer acquired the land from an "associated person", he is deemed to have acquired it at the same date that the associated person acquired it.

In respect of freehold land this will be the moment at which beneficial ownership passed, which is the date of execution of a specifically enforceable agreement for sale and purchase. In Morgan v Beck and Pope (1974) 1 NZTC 61,225 Quillam J, purporting to rely on the authority of A G Healing and Co Ltd v CIR [1964] NZLR 222 held that, where that agreement represents the conversion of rights acquired pursuant to an earlier agreement granting an option, the time at which the question of liability to tax is to be determined is the date of acquisition of that option.

Dr Molloy disagreed with the position reached by Quillam J in *Morgan v Beck and Pope.* He goes on to state:

"It is submitted that the better view is that the equitable property right that is vested in the optionee on the grant of the option is not the right to be treated as beneficial owner of the subject property: it is only the right to prevent the grantor of the option from revoking his offer before the time limited for its acceptance. If the view expressed by Quillam J was correct, it would appear to follow that a taxpayer who acquired an option with no purpose of reselling the subject property once he had exercised it, but who had a subsequent change of mind, so that, by the time he signed the agreement for sale and purchase, following that exercise, he did intend resale, would not have "acquired [the property] for the purpose or intention … of selling" it within the first category!"

It is very interesting to note that Adjudication Report we have sighted, quotes extensively from *Molloy* but fails to make any reference to the *Morgan v Beck and Pope Decision,* possibly because it is a High Court (Supreme Court as it was in those days) decision that is contrary to the line of reasoning that Adjudication Report adopts.

This can be contrasted with two more recent views.

The first of these was Scott Mason's article *"Has the 'Date of Acquisition' for Land Changed" (Taxation Today,* Issue 16 March 2009). In this article Mr Mason uses the example of an elderly couple who had decided to move to central Otago to retire. They agreed to purchase a section in an uncompleted subdivision, however, title in the property was subject to approval under section 255 of the Resource Management Act 1992 ("the RMA"). After two years, title had not been issued and during the two years, the cost of building in central Otago had outstripped the couple's ability to fund the increased cost of building. Accordingly, the couple decided to remain in Dunedin and sell the section. A buyer was found for the section, and the contract for the sale of the couples' section to the proposed owners, was to occur immediately after the couples acquisition of the section. The couple was then investigated by the Department, when it undertook an analysis of quick sales. The couple had bought and sold the sections on the same day, ergo in the Department's view, they had acquired the land with the purpose of sale.

Mr Mason goes on to say:

> *"If these taxpayers had entered into their agreements with the intention of selling the properties, we would have agreed with the IRD that the transactions should have been taxable.*
>
> *However, in each of these cases, the taxpayer has acquired the respective sections for their own personal use, and there has been a change of circumstances leading to the sections being on-sold prior to title being issued.*
>
> *It is our view that the IRD's approach is a means to an end. That is, the IRD have decided that these taxpayers have reaped a windfall which should be taxable, and now are seeking the technical means to get to that outcome by reconsidering how s CB 5 is interpreted. We maintain the view that the IRD has adopted an unsound interpretation of s CB 5 to, in effect, expand the tax base.*
>
> *In reality, what the taxpayer is actually considering their "intentions" when they obtain a contingent or vested legal interest in land (which may be occurring by operation of the RMA 1992/property law)? In fact, how many taxpayers even know they will obtain such distinct interests in land? Therefore, we question how a taxing provision based on intention could possibly be based on such subtle distinctions of interest in land.*
>
> *We concede that IRD's argument is clever, but submit that it ignores Parliament's intentions completely, in relation to both the purpose of the provision and the way in which the terms of the ITA 2004 are defined.*
>
> *Firstly, s CB 5 and its predecessors are there to impose tax on property speculators. Those sections were never designed, and have never been applied (until now, it would seem), to taxpayers who eventually decide, or are forced by circumstances, to sell their land. Secondly, Parliament chose to define "land" extremely broadly and inclusively as including* ***any interest*** *in land, whereas the IRD seeks to narrow that definition to mean only one component, being the legal interest in the land, and ignore previously achieved interests."*

Casey Plunket and Jess Cameron wrote another article that was published on *Taxation Today* May 2009 at page 14. In that they state (page 16):

> *"In our view, the better way to analyse this issue, which results in the same tax outcome, is explained in Australian case law such as Annalong Pty v FCT 72 ATC 4141 (HCA) (Annalong) and a number of Australian Tax Board of Review Decisions…*
>
> *Annalong concerns the application of a provision comparable to s CB 5 ITA 2004. Mason J stated:*
>
> > *'Where a taxpayer buys land under an unconditional and enforceable contract, and subsequently resells it at a profit, it is the taxpayer's intention at or before the making of the contract with respect to the use to which the land is to be put that is, generally speaking, of critical importance. This is because the taxpayer, by virtue of the contract, acquires rights to compel the vendor to vest in him a complete legal and equitable title to the land the subject of the contract. When the contract is completed it may then be said that the property was acquired for the dominant purpose which the taxpayer had in mind at or before the making of the contract.' …………*
>
> *This analysis in our view is in line with non-tax approaches to identifying the time of acquisition, and (is) sensible in its outcome. Obviously, a person who enters into a transaction to acquire property with the dominant intention of making a profit by selling the property should be taxed on the gain. A person who enters into a transaction to acquire property to live in it (for example) should not be taxed on any profit they make on sale, whether that sale occurs shortly after they acquired the property, or many years thereafter. The ruling from the IRD Adjudication Unit suggests that the Unit has rather lost it grasp on the principle of taxation under section CB 5 and its predecessors."*

For completeness, it is noted that:

- The reference to the Australian position refers to an issue which is now effectively redundant in Australia. That is, section 26(a) of the Income Tax Assessment Act 1936 (ITAA36), applied at the time that *Annalong* was heard, and was the then Australian equivalent to our current section CB 6. This is very dated as the section was rewritten as section 25A and that section applied to the sale of property acquired before 20 September 1985, which is when Capital Gains Tax (CGT) commenced in Australia. Under CGT the intention of the taxpayer became irrelevant to whether CGT applied to a transaction.
- Another point to note is that section 26 dealt with "property" – i.e. both personal and real. In the ITAA36, there were no supplementary definitions of "land" or "estate or interest in land" as we have in the New Zealand context. Accordingly, the same arguments raised in this letter could not have been used in Australia.
- Casey Plunket & Jess Cameron seem to accept that New Zealand case law accepts that the relevant time for assessing whether the required purpose or intention existed, is when the purchaser acquires the freehold land[16]. They go on to argue that the better view is the

[16] See *Taxation Today* May 2009 page 14 (They also add as a footnote, that it could also be where the contract is subject to conditions which being solely for the benefit of the purchaser, the purchaser may waive. That was the view expressed in the *Mills Case* however, that has since been overruled by the Court of Appeal in *Bevan v Smith.*)

Australian approach, which considers the taxpayers purpose or intention at the time of making the contract.

So which of these views is correct? There are some factors from the case law and the legislative history of section CB 6 that give a more dispassionate indication of what the correct approach should be.

Both the Adjudication report and the commentators, agree that if a taxpayer has an unconditional contract for the sale of the property, then they have acquired that property. So where do the commentators disagree? The first point of disagreement seems to occur where a person exercises an option – has a person acquired land at that point?

Beetham's Case

In *Beetham's Case* the taxpayer was a lessee of Government land. Under section 122 of the Land Act 1948, the lessee could acquire the fee simple by giving notice and paying the required valuation fee[17]. Section 122(4) provided:

> *"The delivery of the notice to the Commissioner shall constitute a contract between the lessee and the Crown for the purchase and sale of the land."*

After the notice is given, there were various machinery provisions[18], which allow the Commissioner (of Crown Lands) to take into account various factors when determining the value of the land. These included the goodwill arising from the balance of the lease held by the lessee and any improvements made by the lessee. The lessee could challenge the valuation given to them in the Valuation Tribunal. Following agreement on a price, the lessee could either opt to pay the cash price or to pay the land off over time under a "*deferred payment license*". Section 116 of the Land Act 1948 provided that where the lessee either paid the cash or the amounts outstanding under the deferred payment license, then that was the date of "*acquisition of title to the land*".

What had occurred on the *Beetham* facts, was that the lessee gave notice to the Commissioner of Lands on 8 May 1953, which triggered the provisions of section 122. The Department argued that "acquisition" for the purposes of section 88(1)(c) of the Land and Income Tax Act 1954 was when the taxpayer had made (the accelerated) final payment under the deferred payment license on 22 October 1957.

Henry J rejected that argument saying[19]:

> *"I turn now to deal with the situation on 8 May 1953, when the Objector gave notice of his intention to exercise his right to acquire the fee simple of the said land. Upon delivery of that notice a statutory contract was constituted between him and the Crown whereby he contracted to purchase the said land in terms of the Act and the Crown contracted to sell the said land on those terms. There was an enforceable contract between the parties. A right of occupancy as licensee was given until the purchase price was paid. No assurance could be called for by the*

[17] Refer section 122(2) – (3) of the Land Act 1948.
[18] Refer section 122(5) of the Land Act 1948.
[19] Refer *Beetham v CIR* [1973] 1 NZLR 575, 581.

> *Objector until the purchase price had been paid and other obligations in the contract had been carried out. It is clear on the general law that the objector obtained an interest in the fee simple upon the statutory contract coming into existence. It has been stated that interest in commensurate with the relief which equity would give by way of specific performance: Howard v Miller (1915) AC 318, 326."*

This passage is the part that the Adjudication report seized on as the time at which acquisition occurred. But what was the principle behind Henry J's decision? He said (at pages 581-2 commencing line 42):

> *"I reject any claim that the date of acquisition of <u>title</u>, as that term is used in sec. 116 of the Land Act 1948, has the same meaning in respect of real property that 'acquired' has in sec. 88(1)(c) of the Land and Income Tax Act 1954. 'Acquired' in the latter Act is not limited to the acquisition of a registered title which is the sole topic dealt with by sec. 116. The two terms are used in different connotations and neither one throws light on the construction of the other. Section 116 provides for assurance of the title which was purchased and sold. It is part of the statutory context constituted by sec. 122 and defines the assurance which a purchaser is entitled to by virtue of the contract.*
>
> *In Section 88(1)(c) the word 'acquired' is used with respect to both 'real or personal property or any interest therein'. It is a wide term used in respect of every type of property or interest in property. It therefore covers a wide variety of methods of acquisition. It is not for this Court to attempt to substitute other words for those used by the Legislature in an attempt to give a definition. The question simply is, when, on the true construction of sec. 88(1)(c) is a taxing provision dealing with profits or gains derived from (inter alia) real or personal property or any interest therein acquired for certain purposes. In view of the contract which bound the Objector to the purchase, and bound the Crown to sell the said land, I am of the opinion that Objector acquired an interest in it which, by performance of his later obligations under the contract for sale, entitled him to convert, and did in fact convert, that interest so that he became registered proprietor of an estate in fee simple under the provisions of the Land Transfer Act 1952."*

So the Judge was not saying that the taxpayer had to have a right to require specific performance to acquire an interest under section 88(1)(c), what he accepted was that the context applied to a wide variety of methods of acquisition of not only real property, but also "any interest therein".

West Case

In *West v CIR* (1976) 2 NZTC 61,114 this case was virtually a rerun of the *Beetham Case*. The Judge in this case was Chilwill J, who has acted as counsel for the taxpayer in the *Beetham Case.* Interestingly, it was this the second passage we cited from the *Beetham Case* that *Chilwill J* chose as a correct statement of law and as a correct application of the law to the facts of that case[20].

A G Healing and Co Ltd v CIR

This case, *A G Healing and Co Ltd v CIR* [1964] NZLR 222 was not referred to in any of the Adjudication material we have seen, and it was queried by Dr Molloy as being a precedent for the decision in *Morgan v Beck and Pope* (idem).

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[20] Refer *West v CIR* (1976) 2 NZTC 61,114 at pages 61,117-8.

In this case, a testator was a governing director of the company, A G Healing and Co Ltd ("the Company"). In his will, he ordered his trustees, to hold a Wellington leasehold property on trust to sublet or sublease, and to pay the surplus or net rents to his wife during her life. After his wife died, the trustees were to sell the lease of the property, but were to first grant an option to purchase the lease of the land to the Company for £20,000. Once the wife died, the Trustees, who were also directors of the Company, advised the Company that they proposed to sell the property. The Company purchased the property and once it had been transferred to the Company, it was sold for £47,000 the following day. The arguments raised by the taxpayer in this case were quite interesting and the reasoning of the case turns on quite fine points of law. At the time that the case was heard, there were three limbs to section 88(1)(c), the section included as assessable income:

> *"All profits or gains derived from the sale or other disposition of any real or personal property or any interest therein, if the business of the taxpayer comprises the dealing in such property, or if the property was acquired for the purpose of selling or otherwise disposing of it, and all profits or gains derived from the carrying on or carrying out of any scheme or undertaking or scheme entered into or devised for the purpose of making a profit."*

The Revenue had alleged that the taxpayer had either acquired the property for the purpose of resale or that this was a scheme for the purpose of making a profit. The taxpayer argued[21]:

- That the profit or gain was in reality the realisation of benefit conferred under the will, and accordingly that amount was not assessable.
- Alternatively, the purpose for which the appellant acquired the property was not to sell the lease, but to secure the benefit given by the Company by the will.

The Judge dismissed the alternative argument in short order.

The Judge then considered the taxpayer's first argument. The Judge agreed that if the testator had given the Company the lease in his will, then selling the land would not have constituted profit or gain, because the conversion into cash would not have been within the intent or spirit of section 88(1)(c).

The Department argued that the word "acquired" in the second limb of section 88(1)(c) required some positive act from the taxpayer that would have been absent from an outright gift and that by exercising the option, the taxpayer can be said to have acquired the leasehold property[22]. The Judge accepted that view:

> *"I think that Mr Williamson was right when he said that the word "acquired' in the second limb of the paragraph connotes some positive step by the taxpayer which would be absent from an outright gift and that the appellant, by exercising the option conferred upon it by the will, did 'acquire' the leasehold property in that sense."*

[21] Refer *A G Healing & Co Ltd v CIR* [1964] 222, 223 Lines 30-35.
[22] Refer (supra) page 224 at lines 8 – 12.

Note that this position has now been overturned by the cases previously cited – for example, *Congreve and Congreve v IRC* [1946] 2 All ER 170, 183, and *Halliwell v CIR* (idem). So rather than the acquisition occurring when the trustees elected to exercise the option, the acquisition could have occurred a lot earlier than that.

The next crucial factor was that the taxpayer argued that value of the option, being a gift from the testator, had to be taken into account in ascertaining the taxable profit or gain. This point turned on the wording of the will, but the court held that as at the date of death, the taxpayer had a vested interest, and although it could not command specific performance at the date of death (i.e. it still had to wait until the widow died, there was a payment of £20,000 and the trustees had to make a decision to sell the leasehold), these were regarded as being conditions subsequent[23]. The Judge then went on to say[24]:

> *"I have already held that the grant of the option to the appellant was and was intended to be a beneficial proprietary interest. This interest vested on the testator's death, although its enjoyment or realisation was postponed to let in the widow's life interest. I can find no fault with Mr Alper's submission that, in exercising the option, the appellant simply reduced the vested interest into possession, or with his further submission that when was sold the property it converted the testator's gift into money."*

So in essence, the Company had a vested beneficial interest that arose upon the death of the testator, the value of that benefit had to be taken into account by a court in determining whether there was a "profit or gain", when the Company later exercised its option. In relation to the point of when the property was acquired, the Court accepted the Commissioner's submission that this occurred where there was some positive step from the taxpayer. That view has since proved to be wrong, and a person can acquire something merely by receiving it. However, in terms of the current statutory criteria, the person "acquired" the property when the person died, because it was at that point that the grant of the option was a beneficial proprietary interest, which the trustees of the testator's will could not ignore. Note that the relevant legislation that applied in the *AG Healing Case* was section 88(1)(c) of the Land and Income Tax Act 1954. So that the definition of "estate" or "interest" which existed in 1954 Act, arguably did not apply to section 88(1)(c) as that section did not refer to "land" only to "real or personal property". We will deal with this issue in greater detail shortly.

Morgan v Beck & Pope

This was a case that Dr Molloy made reference to as being precedent for the view that where an agreement represents the conversion of rights acquired pursuant to an earlier agreement granting an option, the time at which the question of liability to tax is to be determined is the date of acquisition of that option.

In *Morgan v Beck & Pope* (1974) 1 NZTC 61,225 the plaintiff was suing a firm of solicitors who allegedly failed to either seek consent of the Land Valuation Court or to file a declaration regarding an option to purchase a farm which was contained in a sharemilking agreement dated 10 August 1967. The background to this case was that a son was seeking to buy a farm from his father. The

[23] Refer (supra) page 226 at lines 8-15.
[24] Refer (supra) page 227 at lines 43 – 50.

son was a sharemilker on the farm and as part of a sharemilking agreement dated 10 August 1967, he had an option to buy the farm from his father. This provided that the option was open to until 30 April 1972, and that the son could purchase the property at a fixed price of $40,000. The son was having trouble earning enough money from the farm to pay for the dairy herd, let alone to purchase the farm. In addition, the farm was marginal, and would have required further funds spent on it. Accordingly, the son decided to sell the farm. A purchaser was found for the property who was prepared to pay $70,000 and this occurred under a contract dated 10 December 1969. To facilitate a sale of the property, a sale first occurred from the father to the son, and then from the son to the ultimate purchaser. The sale from the father to the son had to be registered under the Land Settlement Promotion and Land Acquisition Act 1952 ("the LSPLA"). This Act prevented the aggregation of large amounts of land under one person, and there was a requirement to obtain the consent of the Land Valuation Tribunal when either a person purchased farm land or acquired an interest in farmland. The declaration made under the LSPLA referred to an agreement for sale and purchase dated 10 December 1969.

Once Inland Revenue saw the date of the purchase and subsequent sale, it issued an assessment for $13,839. The son challenged Inland Revenue's assessment and took the matter to the Taxation Board of Review. The taxpayer argued that he had an option to purchase under the sharemilking agreement signed on 10 August 1967. One of the members of the Taxation Board of Revenue questioned whether the son had made a declaration and sought approval from the Land Valuation Tribunal for the sharemilking agreement back in 1967, because if the sharemilking agreement had contained an option to purchase, as the son was arguing, then those steps were also required under the LSPLA back in 1967. The son found that his solicitors for the 1967 transaction had not taken the steps that were required under the LSPLA. He withdrew from the tax case and paid the Inland Revenue, but then sued the solicitors who had acted for him in the sharemilking agreement.

The court found that there were two questions to consider:

- Was the shareholding agreement an option which the LSPLA applied?
- If the LSPLA applied, were the solicitors negligent in not filing the required papers under the LSPLA such that the son was now liable to pay tax to Inland Revenue?

Quillam J held that the sharemilking agreement contained a valid option to which the LSPLA applied.

The second issue turned on whether the solicitors had been negligent in not filing the required declaration or seek the consent of the Land Valuation Tribunal. The taxpayer argued that he would have succeeded under the principles of the *AG Healing Case* on the basis that, although in the *AG Healing Case*, the taxpayer's dominant motive in exercising the option was resale, and while the purchase and resale was an undertaking or scheme entered into or devised for the purpose of making a profit, nevertheless the option was a beneficial proprietary interest, and when it exercised the option the Company simply reduced that interest into possession[25].

[25] Refer *Morgan v Beck and Pope* (1974) 1 NZTC 61,225 at page 61,229.

The Commissioner argued that *Healing's Case* could be distinguished as it depended on the fact that the option was conferred as a gift, and it was for this reason that the amount was not subject to tax.

Quillam J said:

> *"It is true that Healing's case was expressly one of gift, but more importantly it stressed that an option is something which is valuable in itself. The time at which the question of liability to tax had to be determined was the time of acquisition of the right of purchase. Was that upon the conclusion of the contract in 1967 or upon the exercise of the option in 1969? Upon the authority of Healing's case, and, I should have thought, upon principle, it was in 1967. The question of whether the option was acquired by gift or by commercial transaction is unimportant. The right came into existence in 1967 and it was a right which could then be exercised at any time within the stated period. I can see no point of distinction arising from the question of gift."*

Accordingly, in *Morgan v Beck and Pope* (idem), it was the time at which the taxpayer acquired the right to purchase the property, which was when the court should determine whether there was a liability to tax (i.e. whether there was a requisite intention or purpose of resale).

Statutory History and Development

Another crucial factor to consider in a discussion of when an option becomes taxable is the statutory language and history of the relevant provisions. This assists in determining the scheme and purpose of the legislation, in so far as that is relevant to determine the intention of Parliament.

The provision that is now section CB 6 of the Act, dates back to an amendment in the Land and Income Assessment Amendment Act 1912 (the 1912 Amendment Act). Section 79 of the Land and Income Assessment Act 1908 provided:

> *"'income derived from business' includes, but without limiting the meaning of the words, the profits derived from or received in New Zealand by any taxpayer, in or out of New Zealand in each year ending the thirty-first day of March, from the following sources:*
>
> *(a) ……………………*
> *(b) ……………………*
> *(c) From the purchase, sale or other disposition of real property, if the taxpayer's ordinary business comprises dealing in such property, but not otherwise.*
> *(d) ………………..."*

Section 54 of the 1912 Amendment Act provided that:

> *"Section seventy-nine of the principal Act is hereby amended –*
>
> *(a) As to paragraph (c) thereof, by omitting all the words of that paragraph after the words 'real property,' and substituting the words 'if the business of the taxpayer comprises*

> *dealing in such property, or if the property was acquired for the purpose of selling it or otherwise disposing of it at a profit.”*

Hansard at second reading of this amendment act (at its Bill stage) provided the following insights as to the purpose of this legislation[26]:

> *“Clause 47, subclause (a): This is not an alteration in the law, but it is for the purpose of making the present Act clearer. Persons who speculate in land are liable to assessment for income-tax on the profits from buying and selling the land.”*

This amendment is useful in that it tells us that the provision was to be applied against land speculators. However, it does not (of itself) tell us when the test land speculation was to be applied. The words “real property” were not defined in the Land and Income Assessment Act 1908.

The Land and Income Tax Act 1916 (the 1916 Act) consolidated a number of previous acts. It also varied the wording of the former section 79 and added a definition of “interest” in land that is relevant for our purposes. The new section 85(c) provided:

> *“All profits or gains derived from the sale or disposition of land or any interest therein, if the business of the taxpayer comprises dealing in property, or if the property was acquired for the purpose of selling or otherwise disposing it at a profit:”*

The amended definition included a reference to “land or any interest therein”, as opposed to the previous term “real property”. In addition, there was a new definition of the terms “estate” or “interest” in land which provided:

> *“’Estate’ or ‘interest’ means any estate or interest in land, whether legal or equitable, and whether vested or contingent, in possession, reversion, or remainder; and includes any right to the possession of land or to the receipt of the rents or profits thereof, or to the proceeds of the sale or other disposition thereof, whether immediate or through a trustee, or otherwise howsoever; but does not include a mortgage:”*

Accordingly, an “interest” in land, following the passing of the 1916 Act could include a legal or equitable interest, whether vested or contingent. The wording of this definition of “estate” or “interest” in land remained unchanged until the advent of Income Tax Act 2004.

The 1916 Act also included a definition of “land owned” that provided:

> *“"Land owned" means an estate or interest owned in land, or deemed to be so owned by virtue of the provisions of this Act:*

This was not relevant to section 85(c) as the term “land owned” was not used. This term was subsequently used in some forestry provisions and provisions dealing with the spreading of income where land had been acquired by the Crown. This definition also remained virtually unchanged until the advent of the Income Tax Act 2004.

[26] Refer *Hansard* 1912 – Vol 159 at page 624.

The Land and Income Tax Act 1923 effectively replicated all the relevant provisions of the 1916 Act, so there was no change.

The Land and Income Tax Act 1954 (the 1954 Act) made a number of changes. One of these changes arguably made the supplementary definition of "estate" and "interest" in land not as directly relevant to the interpretation of the former land speculation provision. The new provision (section 88(c)) referred to:

> *"All profits or gains derived from the sale or other disposition of any real or personal property or any interest therein, if the business of the taxpayer comprises the dealing in such property, or if the property was acquired for the purpose of selling or otherwise disposing of it, and all profits or gains derived from the carrying on or carrying out of any scheme or undertaking or scheme entered into or devised for the purpose of making a profit."*

So the amended provision broadened the ambit of the provision by including personal property as well as land. However, it reintroduced to the 1912 Amendment Act wording of "real property", to replace the word "land".

A further difference between section 88(c) of the 1954 Act and the 1912 Amendment Act was that section 88(c) referred to "*any real or personal property* ***or any interest therein***". The 1954 Act carried over the addition which been originally been included in the 1916 Act of "any interest therein". Arguably any interest in real property would also be an "interest" in land. Accordingly the definition of "estate" or "interest" in land which was also included as a defined term in section 2 of the 1954 Act would have also been relevant to the interpretation of section 88(c). However, it is a longer bow to draw when analysing the meaning section 88(c) to make reference to a definition that doesn't use the same words.

In 1973, the Land and Income Tax Amendment Act 1973 split section 88 into two parts – section 88 which dealt with the taxation of personal property and section 88AA which dealt with the taxation of land. The new provision that dealt with land speculation provided[27]:

> *"(a) All profits or gains derived from the sale or other disposition of any land if the land was acquired for the purpose or intention, or for the purposes or intentions including the purpose or intention, of selling or otherwise disposing of it."*

The changes from the old section 88(1)(c) included that:

- The ambit of the provision was narrowed to only apply to land.
- The other two limbs of the former section 88(c) were now contained in separate provisions.
- The section now applied whether the person had a purpose or intention.
- The section reverted to the use of the term "land".
- The purpose or intention of selling or disposing could be one of a number of purposes or intentions that the person acquired the land for.

[27] Refer section 88A(1)(a).

In addition, there was a new definition of "land" that was included in section 88AA(6) that provided:

> *"(6) For the purpose of this section, the expression 'land' includes-*
>
> *(a) Any estate or interest in land, whether legal or equitable, corporeal or incorporeal, freehold or chattel; and*
> *(b) Any option to acquire land or any such estate or interest in land;-*
>
> *but does not include a mortgage."*

This new definition of "land" had a number of effects:

- It clarified the statutory meaning of the term "land" (i.e. including any estate, whether legal or equitable, corporeal or incorporeal) applied to the land speculation provision.
- It was drafted using words (i.e. "any estate or interest in land") that linked it up with the definition of "estate" or "interest" in land contained in section 2. This clarified the application of the broader definition of "interest in land" to the land speculation provision.
- Accordingly any option to acquire land or an interest in land was within the purview of the new section 88AA.

The Minister's speech on the second reading of Hansard[28] does not cast much light on the issue of when persons acquire land – it merely states:

> *"The existing provisions relating to the taxation of profits or gains from dealing in real property are strengthened in this clause. Profits and gains from real property will now be assessed when, firstly, the property was acquired with the intention as well as the purpose of resale, and, secondly, the property was acquired by a land dealer and either was held as part of his land dealing business and later sold – or, if it was not held as part of his land dealing business but is sold within 10 years of acquisition, for example, claimed to be held as an investment but sold within this 10-year period."*

There were further amendments to section 88AA in 1975, but they did not alter the part of the provision that we are dealing with[29].

The Income Tax Act 1976 (the 1976 Act) represented a separation of land tax out into its own legislation and a consolidation of the income tax part of the 1954 Act. There were no changes to the relevant provisions.

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[28] Refer Vol 385 pp 3313-4
[29] Refer Land and Income Tax Amendment Act (No. 2) No. 18 1975.

Application of statutory history and development to issue of acquisition of land

Dr Molloy had written[30]:

> *"The instant at which the requisite purpose or intention was present, for the purposes of the first category; ………...are questions to be decided as at the moment of acquisition of the land which has been disposed of.*

Therefore, in the case of land acquired for the purpose of resale, the moment of acquisition of the land is the time at which the requisite purpose or intention was to be determined. Dr Molloy then goes on to say:

> *"In respect of freehold land this will be the moment at which beneficial ownership passed, which is the date of execution of a specifically enforceable agreement for sale and purchase. In Morgan v Beck and Pope (1974) 1 NZTC 61,225 Quillam J, purporting to rely on the authority of A G Healing and Co Ltd v CIR [1964] NZLR 222 held that, where that agreement represents the conversion of rights acquired pursuant to an earlier agreement granting an option, the time at which the question of liability to tax is to be determined is the date of acquisition of that option.*
>
> *It is submitted that the better view is that the equitable property right that is vested in the optionee on the grant of the option is not the right to be treated as beneficial owner of the subject property: it is only the right to prevent the grantor of the option from revoking his offer before the time limited for its acceptance."*

The reasons why Dr Molloy's argument was incorrect were that:

- The definition of "land" now included "*Any option to acquire land or any such estate or interest in land."*
- The "land" is therefore acquired when the optionee acquires the option, not when the optionee exercises the option.
- Therefore, the moment to decide whether the optionee acquired the land with the intention or purpose of disposal is at the time when the optionee acquired the option.

There are a number of points that can be made from this:

An option is different to rights acquired under a conditional sale contract
The option that Dr Molloy is talking about is different species of equitable interest to the rights acquired by a purchaser under a conditional contract of sale (which is the situation that Scott Mason was referring to). For example in *Laws of New Zealand – Sale of Land* by DF Dugdale & Justice Chambers it states[31]:

> *"An option to purchase an interest in land is a contract under which the grantor of the option promises to sell the interest in to the grantee on certain stated terms, if the grantee, within a*

[30] Refer *Molloy on Income Tax* Butterworth 1976 para 406.
[31] Refer page 4, at para 3.

> *certain time limit, communicates to the grantor an election to purchase. An option, although resembling both an irrevocable offer and a contract subject to a contingent condition, is properly to be regarded as sui generis."*

However, Mr Dugdale went on to say *"Prior to the exercise of the option the grantee owns a contingent equitable interest in the land."* - Citing *Morland v Hales*(1910) 30 NZLR 201 and *Buyn v Ogg* [1967] NZLR 279) as authority for that principle. This is consistent with our previous comments that the definition of "estate" includes an equitable interest in land. So even if the definition of "land" had not specifically included "*an option to acquire land*" it would have also been included as "*an estate in land*" as it was an equitable interest in land.

Are there any arguments against the proposition that statutory change relating to options clarified that an earlier time of acquisition was appropriate? There are possibly two arguments:

Dr Prebble in his book *The Taxation of Property Transactions*[32] notes that the definition of "land" includes options and suggests that this was included to overcome the effect of the *AG Healing Case*. That is, if a person acquires an option in 1980 for $10,000 and sold that option in 1990 for $80,000, then the person would be assessable on the $70,000 less their expenses. Dr Prebble suggests that the intention to overcome the *AG Healing Case* may not be effective, as profits can arise from the sale of "land", and although an option is "land" for the purposes of the definition, it is not the same land that is ultimately sold. This is possibly drawing the Court of Appeal's decision in *CIR v Walker* [1963] NZLR 348, 362 where North J said:

> *"``I do not doubt that in Bedford Investments Ltd. v Commr. of I.R. (1955) 10 A.T.D. 464, McGregor J., was right when he interpreted the word 'property' on each occasion it is used in sec 88(c) as referring to the same subject matter, and therefore, in the present case the 'purpose' must be found in relation to that part of the 63 acre block which was sold.*

Dr Prebble suggests that the inclusion of the definition of "options" is effective to prevent the sale of an option from one person to another, but it would not be effective if a person exercised that option to acquire the land as the land is different "land" to that which is sold.

However, that argument was specifically overcome by section 9 of the Land and Income Tax Amendment Act 1973 which provided:

> *"(7) This section shall apply where the land sold or otherwise disposed of constitutes the whole or part of any land to which this section applies or the whole or part of any such land together with any other land."*

An option is a partial interest in the land and we suggest that a court would have very little difficulty in overcoming the argument that the "land" had to be the same "land" that was sold.

[32] Refer Butterworths 1986 ISBN 0-409-787-40-X

Secondly, if Dr Prebble was correct, it would be possible that a land transaction involving an option would have two separate tax outcomes. If a person acquired the option to buy the land without an intention to sell the land, then the exercise of the option would not be subject to tax, but if the person decided to sell the land before they exercised the option, then that part of the sale price that was attributable to the sale price (but not the option) would be assessable. We think that this is a bizarre outcome and that cases such as *A G Healing* are strong support against such a result.

The second possible argument against the proposition that statutory change relating to options clarified that an earlier time of acquisition was appropriate comes from some dicta of Barker J in *Anzamco (in liq) v CIR* (1983) 6 NZTC 61,522 at page 61,528 where he states:

> *"The appropriate time at which to consider a taxpayer's intention or purpose under this provision is the date of its acquisition of the land. On the facts of this case, this must mean the date on which the option is exercised, not the date it was given, which may be the appropriate date in other fact situations. The option makes no reference to obtaining capital issues consent; the option could not have been implemented without that consent."*

In *Anzamco* the taxpayers were buying two blocks of land. On 26 February 1966, the taxpayer obtained an option to purchase 1,952 acres from Bio-Lab Developments Ltd and on 11 March 1966 it obtained an option to purchase 18,386 acres from the Tuhoe Maori Trust Board.
To raise funds for the purchase, the taxpayer needed to raise further funds offshore. However, at that time, the raising of funds offshore was unlawful unless the it was with the consent of the Minister of Finance (see the *Capital Issues (Overseas) Regulations 1965* reg. 3(1)(a) & (d)). No reference was made in the option documents for the requirement of the Minister's approval and the Judge held that the options must be read in light of the requirement. Hence the Judge concluded that the acquisition must occur at a later date.

There are at least three points to note from this decision. The first was that the taxpayer finally obtained a suitable Ministerial consent in a letter dated 2 February 1967, and the taxpayer exercised the options to purchase with the vendors of the land and possession was taken on 20 February 1967. So broadly speaking, it was only after the taxpayer agreed to the Ministerial consent conditions on 9 February 1967 that the vendor was in a position to exercise the option. The land was ultimately sold on 2 May 1980, so the sale of the land was covered by section 67 of the Income Tax Act 1976 which included the statutory references to "*land including any option to acquire land or any such estate or interest in land*." Although Mr Justice Barker's comments made sense from a practical perspective (i.e. the contract could not have proceeded unless the taxpayer had the ability to raise the necessary funds) it would seem that his comments were made per incuriam of the cases cited by Mr Dugdale and Justice Chambers (i.e. *Morland v Hales* (1910) 30 NZLR 201 and *Buyn v Ogg* [1967] NZLR 279 - which held that prior to the exercise of an option, the grantee owns a contingent equitable interest in the land).

So how does this the outcome of the option as an option is a different "species" of equitable interest in land than an equitable interest in land that arises under a conditional contract? Just because an option is another form of equitable interest in land, this does not mean that the principles that apply to an option automatically applicable to a conditional sale. However:

1. It is a demonstration of how the statutory wording reflected the intention of when the test of intention or purpose should be employed.
2. Given the close legal nature of an option to both an irrevocable offer and a contract subject to a contingent condition[33], it would seem anomalous if there were different times were applied to types that are inherently similar.
3. When considering these three categories referred to *Laws of New Zealand* (i.e. an unconditional contract, an option, and a contract subject to a condition), it would seem perverse if the contract subject to a condition was to have a different time of acquisition to the other two, given the Court of Appeals decision that there is an equitable interest exists where there is a condition subsequent.
4. As discussed by the Court of Appeal in *CIR v Walker* (idem), the time at which a person's tax liability is triggered under a scheme, is when the scheme is formulated. By parity of reasoning, the taxability of a person who is subject to tax for the acquisition of land with the intention or purpose of sale, should also have the timing determined when they first when into the acquisition of that property.

Summary
In summary, we consider that:

1. The issue of when land is acquired under section CB 6 of the Act is a matter of statutory interpretation.
2. The time that the purpose or intention is determined is at the time that the land is acquired.
3. The definition of "land" includes an estate in land, whether legal or equitable, vested or contingent.
4. Where a person holds an option to acquire land that is also defined as "land" and accordingly the holding of an option to acquire land is the holding of "land".
5. An option is also type of equitable interest that can be held in property.
6. Where a person agrees to purchase property under a conditional contract of sale, the Court of Appeal in *Bevan v Smith* found that where a contract is a condition subsequent, then an equitable interest will pass to the purchaser.
7. Under the standard conveyancing agreements used for domestic properties in New Zealand, the agreements are drafted as a condition subsequent. Accordingly under those agreements, a taxpayer will acquire a contingent beneficial interest in the property upon the signing of the standard form agreement, even if the contract is conditional.
8. Therefore, a taxpayer who has acquired an interest under a conditional contract to purchase land using a standard form ADLS agreement or Real Estate Institute of

[33] Refer to our quote from Laws of New Zealand which stated:" *An option, although resembling both an irrevocable offer and a contract subject to a contingent condition, is properly to be regarded as sui generis.*"

New Zealand agreement, should have their intention to resell the property assessed at the time at which they signed the agreement (i.e. not when the condition in the agreement becomes unconditional).

9. We disagree with Inland Revenue's view that the intention should be assessed at the time when the condition in a conditional agreement is fulfilled, as that reasoning is based on the *Mills Case* which was considering a different issue – i.e. whether there had been a "sale or other disposition" had been made - this is a completely different issue to whether a person has acquired any estate or interest in land whether legal or equitable, or whether vested or contingent, in possession, reversion or remainder. The Judge in that case noted that:
    a. the legislature had chosen the expression "sale made" and not "contract entered into".
    b. In the *Mills Case* that both counsel accepted that it was the contract that was the relevant document to consider, as opposed to the option or notice of election in the *Beetham Case* (i.e. which had considered the statutory interpretation of the meaning of the word "acquired").

    It seems ironic that the *Mills Case* that Inland Revenue relies on has already distinguished itself from the statutory interpretation that Inland Revenue is seeking to draw from it. In *Beetham's Case* Henry J cautioned against using the meaning of "acquired" in section 116 of the Land Act 1948 and applying it to section 88(1)(c) of the Income Tax Act 1954. Inland Revenue has gone one step further and taken the meaning of "acquired" in section CB 6 of the Act from different words altogether. Henry J went on to say that the word "acquired" was a very wide term which was used in respect of every type of property or interest in property. He felt that it was not for the Court to substitute other words for those used by the Legislature in an attempt to give a definition. In our view, the legislation has been clarified since that time by more clearly defining the types of interest covered by the meaning of the term "land" and "estate or interest" in land. Further other cases such as *West, AG Healing* and *Morgan v Beck and Pope* provide strong support for that view.
10. We accept that the position regarding options is not exactly the same as that arising under a conditional contract. However, these are both contingent beneficial interests and are a clear reflection of what was intended under the statutory language. Given the close legal nature of an option, an irrevocable offer and a contract with a contingent condition, it would be anomalous if these were to be treated differently under section CB 6 of the Act. Similarly, the Court of Appeal in *Walker's Case* (idem) held that timing of determining when person is liable to tax under a scheme is when the scheme or undertaking is devised[34].

[34] See also *Gilmour v C of IR* [1968] NZLR 136

Examples

Rebekah Example

In the Rebekah example, the facts state –

> “*Her original intention is to live in the home once it is completed. However, before the property has gone unconditional she decides that she no longer wishes to live in the area.*
>
> *Rather than back out of the contract, she decides to on-sell her interest for $320,000.*
>
> *Because the sale occurred before the contract went unconditional, the $30,000 that Rebekah made on the deal is taxable income and should be included in her tax return*.”

When Rebekah paid her $1,000 deposit, she acquired “an option to acquire land or an estate or interest in land”. This arises as follows:

- Either the payment of the deposit would result in an option to acquire the land; or
- (depending on the drafting of the deposit) Rebekah would have acquired an estate or interest in land being a legal interest which is contingent on the developer completing the subdevelopment and being able to offer good title.

At the time that the “option to acquire land or an estate or interest in land” was acquired by Rebekah, her intention was to live in the property. Accordingly, it doesn’t matter that before the property to purchase went unconditional, she changed her purpose or intention. That is not the correct test. The relevant test of purpose or intention is applied at the time that Rebekah purchased her “option to acquire land or an estate or interest in land”.

Jeff Example

Similarly in the Jeff example, the brochure states:

> “*Recognising that property values in the area are rising, in 2003 Jeff decides to use some of his university funds to buy a $290,000 home. He pays a $1,000 deposit with the balance due on settlement. By the following year, property values have risen sharply. Jeff decides to sell his interest to another buyer for $350,000.*
>
> *The $60,000 Jeff has made on the deal is taxable income and should be included in his tax return. In this case, because Jeff always intended to sell the property the profit will always be taxable regardless of whether the property title has been issued or not.”*

When considering the required purpose under section CB 6 of the Act, a purpose of disposal must be distinguished from the possibility that a person may sell if the right circumstances arise. For example in *Jurgens & Doyle v CIR*, the Court said[35]:

> “*As a corollary, there is no taxable purpose where acquisition is “without any definite purpose in view at all, or merely in a vague general hope that it would be a good investment” (Casey J in C of IR v National Distributors Limited, supra, albeit referring to sec 65(2)(e) involving dominant purpose). Of course, any asset, acquired at any time, by any person, may and probably will ultimately be sold at some time in the future. Purpose or intention to sell are not to be equated with such mere future possibilities.”*

In the facts, we are first told that Jeff notes that property in the area is going up in value. Later in the example we are told that Jeff is taxable because he always intended to sell the property. The two statements are not the same thing. The mere fact that someone may contemplate selling an investment at some time in the future, is not the same as acquiring it with a purpose of sale. The analysis in the brochure flies in the face of existing case law.

General

We encourage Inland Revenue to publish its views, as that makes it easier for taxpayers to comply. However, the views that Inland Revenue publish must have a correlation with its statutory powers and existing case law. In this brochure, the position taken is that in both examples, the amount the taxpayer derives is clearly taxable income. In our view, in the case of Rebekah that example is clearly wrong. In the case of Jeff, it is strongly arguable that this example is also wrong.

We note that the example cautions that a person should take advice from a “tax agent registered” with Inland Revenue. However, we consider that the brochure is clearly misleading and may result in people paying tax where there is no liability under the law.

[35] Refer supra at page 7,081.