Inland Revenue
Te Tari Taake

EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY | HUKIHUKI HURANGA - MŌ TE TĀKUPU ME TE MATAPAKI ANAKE

Deadline for comment | Aukatinga mō te tākupu: **13 August 2026**

Please quote reference | Whakahuatia te tohutoro: **PUB00519**

Send feedback to | Tukuna mai ngā whakahokinga kōrero ki
public.consultation@ird.govt.nz

Notes | Pitopito kōrero: We previously consulted on this draft item as a 'questions we've been asked' in December 2024 and received a range of submissions. After considering that feedback, we have refined our view on how s CB 3 applies, particularly its relationship with ss CB 12 and CB 13. We are reconsulting on that basis.

The key aspects of our revised thinking are:

- We no longer consider that ss CB 12 and CB 13 comprehensively tax all undertakings or schemes involving development or division. These provisions materially differ in scope and application from s CB 3, and there is nothing to suggest they were intended to replace s CB 3 for land disposals.
- This does not undermine the exclusions to the land sale rules (including the exclusions to ss CB 12 and CB 13). The exclusions relate to the capital use of land (for example, as a residence or business premises). An undertaking or scheme under s CB 3 is separate to and does not relate to any capital use of the land.
- In most cases, where an exclusion to a land sale rule applies, s CB 3 will also not apply because the sale is simply the realisation of a capital asset. However, where the activity goes beyond mere realisation, such as the construction of one or more dwellings, s CB 3 may apply.

This updated draft reflects these revised views and provides further guidance on what constitutes an undertaking or scheme, including the limits recognised by the courts. It also includes new and expanded examples to better illustrate when s CB 3 will, and will not, apply.

Due to the more comprehensive nature of the analysis and guidance in this updated version, we have converted it to an interpretation statement.

INTERPRETATION STATEMENT | PUTANGA WHAKAMĀORI

When a disposal of land will be part of a profit-making undertaking or scheme subject to income tax under s CB 3

Issued | Tukuna: Issue date

IS XX/XX

Section CB 3 provides that an amount derived from an undertaking or scheme for the purpose of making a profit is income of a person. This interpretation statement considers whether disposals of land can be subject to income tax under s CB 3 or whether the land sale rules in the Act are a code that comprehensively covers when land disposals are taxed. This interpretation statement concludes that s CB 3 can apply to tax disposals of land and provides guidance on when this may be the case.

Legislative references are to the Income Tax Act 2007 (the Act) unless otherwise stated.

Contents | Ihirangi

Summary | Whakarāpopoto

1. Section CB 3 taxes amounts derived from profit-making undertakings or schemes. There have been different views on whether the land sale rules in the Act are a code that comprehensively covers when land disposals are taxed. We have been asked the Commissioner's view on this.

2. The Commissioner considers that the land sale rules are not a code and that s CB 3 can apply to tax disposals of land. In summary, the main reasons for this are as follows:

   - The plain words of s CB 3 states that it applies to any amount derived from a profit-making undertaking or scheme. Nothing in the land sale rules states that these are the only provisions that can apply to land disposals.
   - The legislative history suggests the purpose of implementing the land sale rules was to strengthen and supplement existing taxing provisions in the context of land disposals, rather than to narrow them by creating a separate scheme to comprehensively tax land disposals.

- What is now s CB 3 was originally in a provision containing three limbs, the first two of which (from 1973) concerned disposal of personal property only. The Commissioner does not consider the first two limbs were intended to "colour" the meaning or scope of what is now s CB 3. The plain wording of the provision, both then and now, is not limited to profits from disposal of personal property only or, for that matter, to profit-making undertakings or schemes involving disposal of property at all.
- There is case law support for the view that s CB 3 can apply to disposals of land, despite the expansion of the land sale rules in 1973.
- Differences in the scope of s CB 3 and ss CB 12 and CB 13 suggest ss CB 12 and CB 13 were introduced to tax amounts from undertakings or schemes involving land that would otherwise not necessarily be caught by s CB 3. There is nothing to indicate ss CB 12 and CB 13 were intended to replace s CB 3 for land disposals.
- It is not considered that s C 3 being able to apply to disposals of land undermines the exclusions to the land sale rules. If an exclusion to a land sale rule applies, in most cases s CB 3 will not apply because the sale is simply the realisation of a capital asset. Where an exclusion applies but s CB 3 could nonetheless tax the disposal, it is because the profit-making undertaking or scheme is separate from the person's capital use of the land.

3. In addition, this interpretation statement provides guidance on and examples of when s CB 3 may apply to a disposal of land, which can be summarised as follows:
   - The first consideration is whether there is a land sale rule that applies to the disposal. If there is, the relevant land sale rule takes priority over s CB 3.[1]
   - If there is no land sale rule that applies, s CB 3 may potentially apply.
   - In most cases, if an exclusion to a land sale rule applies, s CB 3 would not apply. However, s CB 3 will apply if there is a profit-making undertaking or scheme separate from the capital use of the land (which is what the exclusions cover).
4. Table | Tūtohi 1 summarises the relevant factors to consider for s CB 3 to apply.

[1] The taxing provision that applies can be relevant to the deductions available.

Table | Tūtohi 1 – Summary of relevant factors for s CB 3

Requirements for s CB 3	Summary
The disposal of the land is part of an udertaking or scheme.	• An undertaking or scheme is a plan, design or programme of action devised to attain an end result. • Not a great deal is needed for an undertaking or scheme.
The undertaking or scheme is carried on for the dominant purpose of profit.	• There may be more than one purpose for entering in the undertaking or scheme. The purpose of profit making must be the dominant or main purpose. • The focus is on the taxpayer's subjective purpose at the start of the undertaking or scheme. But this is assessed objectively based on the facts.

The disposal is more than the mere realisation of a capital asset, which includes realisation at best advantage.	• The distinction between mere realisation of a capital asset at best advantage and a profit-making undertaking or scheme may not always be clear and is a matter of fact and degree.
	• The key consideration is whether the taxpayer is merely disposing of the asset in a way that maximises returns or makes it more attractive to buyers, or whether something new is created or the character of the asset is changed significantly.
	• In the context of land, mere realisation would likely include:
	  ○ subdivision of land that does not involve significant work; or
	  ○ undertaking repairs or renovations typically involved in preparing a capital asset for sale.
	• An undertaking or scheme would likely go beyond mere realisation if it involves:
	  ○ extensive subdivision with infrastructure;
	  ○ building new dwellings; or
	  ○ significant transformation of the property's character, such as extensions to a dwelling.

Introduction | Whakataki

5. Section CB 3 provides that an amount derived from an undertaking or scheme for the purpose of making a profit is income of a person:

> **CB 3 Profit-making undertaking or scheme**
>
> An amount that a person derives from carrying on or carrying out an undertaking or scheme entered into or devised for the purpose of making a profit is income of the person.

6. There has been uncertainty around whether s CB 3 can apply to tax disposals of land. There are various provisions in the Act relating to disposals of land (ss CB 6A to CB 23B). It has been suggested that these land sale rules are a code, meaning that amounts derived from the disposal of land are subject to tax only if one of those rules applies, and that other provisions such as s CB 3 cannot apply to disposals of land. We have been asked the Commissioner's view on this.

Analysis | Tātari

Are the land sale rules a code?

7. The Commissioner considers that the land sale rules are not the only provisions of the Act that could apply to tax amounts derived from the disposal of land. In other words, the land sale rules are not a code.

8. Under s 10(1) of the Legislation Act 2019, the meaning of legislation must be ascertained from its text and in light of its purpose and its context.

9. The Commissioner's view that s CB 3 can apply to disposals of land is based on the words of s CB 3 and the various land sale rules, the scheme of the Act, the legislative history and relevant case law. Having regard to all of those considerations, there is no clear indication that Parliament intended that the land sale rules would apply to tax the disposal of land to the exclusion of all other provisions of the Act.

10. The text and context of the legislation, and what can be gleaned about its purpose, do not indicate that s CB 3 cannot apply to disposals of land.

11. On the plain words of the provision, s CB 3 states that it applies to any amount derived from a profit-making undertaking or scheme.

12. No provision in the land sale rules states that the land sale rules are the only provisions that can apply to an amount derived from the disposal of land.

13. Schematically and contextually, the headings in Part C do not suggest any restriction to the scope of s CB 3, or that the land provisions were intended to be a code. Rather, the headings are included to assist with navigation of the Act.

14. Part C is titled "Income". Subpart CA is headed "General rules" and subpart CB "Income from business or trade-like activities". Section CB 3 is under its own subheading of "Schemes for profit". If the subheading "Land" before ss CB 6A to CB 23B were intended to make those provisions a code in relation to amounts derived from the disposal of land, there would be no ability for such amounts to fall within the general provisions (for example, s CA 1(2) (income according to ordinary concepts) or s CB 1 (business income)).

15. Further, if the "Land" subheading were intended to make those provisions a code for taxing disposals of land, the same logic would (presumably) apply to other subheadings in subpart CB. This would suggest, for example, that the subheading "Personal property" before ss CB 4 and CB 5 was intended to make those provisions a code for taxing amounts derived from the disposal of personal property. Such an interpretation would severely limit the scope of s CB 3, as it would not apply to any undertaking or scheme involving the disposal of any kind of property. There is no question that s CB 3 can apply to the disposal of personal property.

16. Considering the wording of the land sale rules in light of their purpose, there are indications from the legislative history that Parliament did not intend the land sale rules to be a code, and that Parliament did not intend to remove land from the scope of what is now s CB 3.

17. Prior to 1973, s 88(1)(c) of the Land and Income Tax Act 1954 contained what are now ss CB 3, CB 4, and CB 5. Both personal and real property were explicitly referred to in the first two limbs of s 88(1)(c), which applied to disposals of property as part of a business or where the property was acquired for the purpose of disposal. Amendments in 1973 removed references to real property from this provision and added in new s 88AA, which brought in the majority of the current land sale rules.

18. It could be argued that the removal of real property from s 88(1)(c) of the 1954 Act and creation of a new provision for land disposals was intended to remove land from the scope of the third limb, which eventually became s CB 3.

19. However, the third limb did not refer to disposal of property at all and was not changed in the 1973 amendments. Largely consistent with the current wording of s CB 3, the third limb applied to "all profits or gains derived from the carrying on or carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit".

20. At the first reading of the Bill that introduced the new rules, the Minister of Finance, Hon WE Rowling commented that the new rules were intended to "strengthen the tax

provisions relating to profits or gains from the disposal of real property" to reflect the recommendations of the Ross Committee.[2] This suggests the purpose of implementing the land sale rules was to strengthen and supplement existing taxing provisions in the context of land disposals, rather than to narrow them by creating a separate scheme to comprehensively tax land disposals.

21. While the three limbs of s 88(1)(c) were in the same provision, and from 1973 the first two limbs concerned disposal of personal property only, the Commissioner considers the first two limbs were not intended to "colour" the meaning or scope of the third limb (now s CB 3) or limit its application to disposals of personal property.

22. On the contrary, the plain wording of the relevant provision, both then and now, is not limited to profits derived from disposal of personal property only or, for that matter, to profit-making undertakings or schemes involving disposal of property at all. This is supported by case law.[3]

23. In addition, though later than the 1973 amendments, the subsequent splitting out of the three limbs into separate provisions gives some indication that Parliament itself did not intend for the third limb to be coloured by the first two. In particular, s CB 3 has been separated from the personal property provisions since the Income Tax Act 2004 and since then has sat under the separate subheading "Schemes for profit", rather than the "Personal property" subheading for ss CB 4 and CB 5.[4]

24. Prior to this, for a short period during the rewrite process[5] when these three provisions were in one provision, it had the heading "Personal property". However, the inclusion of that heading was during a period in which the entire Income Tax Act was being rewritten and reorganised, so it is considered that this does not indicate Parliament intended that what is now s CB 3 could apply only to personal property. In addition, headings were not at that time interpretively relevant.[6] The separation of the provisions and the creation of a new "Schemes for profit" subheading for s CB 3 in 2004 occurred after headings became relevant legislative interpretation aids.[7]

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[2] *Hansard* (10 August 1973) 385 NZPD 3126.

[3] For example, in *Case Q39* (1993) 15 NZTC 5,187 (TRA), Judge Barber found that one of the predecessors to s CB 3 (s 65(2)(e) of the Income Tax Act 1976) applied to tax the proceeds of a pyramid scheme game, which did not involve disposal of any personal property or real property.

[4] Sections CB 2, CB 3 and CB 4 of the Income Tax Act 2004 were the equivalent provisions to what are now ss CB 3, CB 4 and CB 5 respectively.

[5] From the 1997-98 income year (per the Taxation (Core Provisions) Act 1996) until 1 April 2005 (per the Income Tax Act 2004).

[6] Under s 5(f) of the Acts Interpretation Act 1924, headings were explicitly stated not to affect interpretation.

[7] Under s 5(3) of the Interpretation Act 1999, now s 10(4) of the Legislation Act 2019.

25. Another indication from the legislative history that land was intended to remain in the scope of what is now s CB 3 following the 1973 amendments is s 106(1)(l) of the Income Tax Act 1976. That provision denied a deduction for losses incurred on the disposal of premises.[8] However, the provision did not apply in the case of the disposal of premises where, had a profit been made, it would have been assessable income under s 65(2)(e). The third limb of s 65(2)(e) of the 1976 Act contained what is now s CB 3, and was the only limb that could apply to the disposal of premises as the other limbs, by that point, concerned only personal property.

26. The explicit reference in s 106(1)(l) to the disposal of premises being capable of being taxed under s 65(2)(e), and the third limb of s 65(2)(e) – what is now s CB 3 – being the only limb that could apply to disposals of land, indicates Parliament contemplated that what is now s CB 3 could apply to the disposal of land, even after new rules explicitly targeting the disposal of land were introduced. This provision, and the associated proviso, carried on to s DD 1(c) of the Income Tax Act 1994.[9]

27. Finally, there is case law support for the view that the 1973 amendments did not prevent the third limb of s 88(1)(c) from applying to land, and that subsequent versions of the relevant provision continue to apply to disposals of land, despite the existence and expansion of the land sale rules.[10]

What about ss CB 12 and CB 13?

28. It has been suggested that the existence of ss CB 12 and CB 13 support the view that the land sale rules are intended to be a code. Sections CB 12 and CB 13 apply where there is an undertaking or scheme that:

- is not necessarily in the nature of a business;
- involves the development of the land or division of the land into lots;
- for s CB 12, was commenced within 10 years of acquisition of the land and the development or division work is not minor work; and
- for s CB 13, was commenced more than 10 years after the land was acquired (s CB 12 does not apply), none of the other land sale rules apply (except s CB 15), and there is significant expenditure on specified works.

[8] Other than a temporary building.

[9] The proviso was repealed in 1996, but this is because it was no longer considered necessary due to changes to the core provisions allowing a deduction. See Tax Information Bulletin Vol 8 No 9 (November 1996) at 15.

[10] *Case 3/2021* (2021) 30 NZTC 6,002 (TRA); *Lowe v CIR* (1981) 5 NZTC 61,006 (CA); *Dobson v CIR* (1987) 9 NZTC 6,025 (HC); *Case S86* (1996) 17 NZTC 7,538 (TRA).

29. For more information about when ss CB 12 and CB 13 apply, see QB 15/04: **Income tax – whether it is possible that the disposal of land that is part of an undertaking or scheme involving development or division will not give rise to income, even if no exclusion applies** and IS 20/08: **Income tax – when is development or division work "minor"?**.

30. Sections CB 12 and CB 13 are more recent provisions than s CB 3[11] that tax amounts derived from the disposal of land as part of an undertaking or scheme. They are more specific provisions than s CB 3 in relation to the taxation of certain undertakings or schemes – those involving the development of land or the division of land into lots. There is an interpretive presumption that specific provisions override general provisions to the extent they are inconsistent (*generalia specialibus non derogant*, or *lex specialis*).

31. Given the potential overlap between these provisions, the existence of ss CB 12 and CB 13 could arguably support the view that Parliament intended those provisions to comprehensively tax disposals of land as part of an undertaking or scheme. In turn, it could be argued that this supports a view that Parliament intended for land disposals to be taxed comprehensively by the land sale rules.

32. However, in practice, the Commissioner considers there is no inconsistency between s CB 3 and ss CB 12 and CB 13.

33. While there is potential for overlap, there are differences in the scope of the provisions. In *Lowe v CIR*, Richardson J highlighted[12] that there were significant differences between what are now ss CB 3 and CB 12.[13] Most relevantly, that s CB 12 contains no requirement for a profit-making purpose, and that it expressly negates any need for an undertaking or scheme to constitute an adventure in the nature of trade or business, whereas s CB 3 contains no such reference.[14] On this basis, Richardson J considered limitations imposed on the application of what is now s CB 3 (both in the wording itself and as interpreted by the courts) were excluded in the enactment of what is now s CB 12.[15]

34. These differences suggest ss CB 12 and CB 13 were introduced to tax amounts from undertakings or schemes involving land that would otherwise not necessarily be

[11] Sections CB 12 and CB 13 were introduced by the 1973 amendments referred to from [17].

[12] At 61,021 to 61,022.

[13] These differences also exist between s CB 3 and s CB 13.

[14] See from [54] for discussion on the relevance of an undertaking or scheme having the character of a business deal in s CB 3.

[15] At 61,022.

caught by s CB 3.[16] There is nothing to indicate ss CB 12 and CB 13 were intended to replace s CB 3 for land disposals.

35. Another distinction between the provisions is that ss CB 12 and CB 13 apply to undertakings or schemes involving development or division. Notably, courts have stated that these terms do not include building work or other improvements to land. Building work means the construction of buildings, and includes excavation and foundation work on the land for the purpose of construction.[17] Whether work on land is preliminary to construction or part of the construction process is a question of fact.[18]

36. If s CB 3 could not apply to an undertaking or scheme involving development or division, a person could escape taxation by including a minor amount of development or division work in a much larger land improvement or construction project. It is considered Parliament would not have intended this outcome.

37. In addition, for reasons outlined from [67], if an exclusion to a land sale rule applies, including an exclusion to ss CB 12 and CB 13, in most cases s CB 3 will not apply. Where an exclusion applies but s CB 3 could nonetheless tax the disposal, it is because the profit-making undertaking or scheme is separate from the person's capital use of the land.

38. For these reasons, the Commissioner considers that ss CB 12 and CB 13 do not comprehensively set out all the circumstances in which the disposal of land as part of an undertaking or scheme involving development or division work may be taxed, and the existence of these provisions does not support the view that the land sale rules are a code.

Does that mean section CB 3 applies to amounts derived from the disposal of land as part of any profit-making undertaking or scheme?

39. No. While the wording of the provision appears wide, in practice, s CB 3 will only apply to amounts derived from the disposal of land in certain circumstances.

40. The meaning of "undertaking or scheme" in the Act was addressed in detail in IS 20/08 and QB 15/04.

[16] Consistent with observations from McMullin J at 61,033. McMullin J highlighted the differences between the respective provisions and stated that it is against this legislative background that s 88AA(1)(d) (the original predecessor to s CB 12) was to be considered.

[17] *Case R7* (1994) 16 NZTC 6,035 at 6,046.

[18] As stated in IS 20/08 at [64].

41. In short, an undertaking or scheme is a plan, design or programme of action devised to attain some end and includes a project or an enterprise.[19] There must be a coherent plan or purpose which involves a series of steps directed to an end result.[20] Not a great deal is needed for an activity to constitute an undertaking or scheme.[21]

42. On the face of it, this would seem to suggest that s CB 3 has broad application. However, not all undertakings or schemes involving the disposal of land are within the scope of the provision.

43. The courts have interpreted the scope of s CB 3 in a way that limits its application. Of particular relevance to land disposals, for s CB 3 to apply, the undertaking or scheme must be carried on for the dominant purpose of making a profit[22] and the amount derived must not be from the mere realisation of a capital asset.[23] Dominant purpose of making a profit is discussed from [46], and the scope of mere realisation is discussed from [49].

What provision takes priority if a land sale rule applies?

44. The Commissioner considers that, if a land sale rule applies to the disposal of land, the disposal should be taxed under the relevant land sale rule. This is consistent with the *lex specialis* interpretive presumption, as the land sale rules are more specific provisions relating to the disposal of land. It is also consistent with s DB 26,[24] which allows a deduction when an amount is derived from the disposal of property under s CB 3, but only where the amount is not income under any other provision. This indicates s CB 3 is intended as a "catch-all" for amounts that are not income under other provisions. It remains open to the Commissioner to argue s CB 3 as an alternative to a land sale rule.

45. The taxing provision that applies can be relevant to the deductions available. That is, whether the deduction available for the land is the cost of the land, or the market value at the start of the profit-making undertaking or scheme. See from [76] for more information about available deductions when s CB 3 applies.

[19] *Vuleta v CIR* [1962] NZLR 325 (SC) per Henry J, at 329.

[20] *Case S86* at 7,548.

[21] *Lowe* at 61,020.

[22] *CIR v National Distributors Ltd* (1989) 11 NZTC 6,346 (CA).

[23] *Beetham v CIR* 72 ATC 6042 (NZSC); *Eunson v CIR* [1963] NZLR 278 (SC) at 281. See also *FCT v Whitfords Beach Pty Ltd* (1982) 39 ALR 521 (HCA).

[24] Discussed further from [76].

What is a dominant purpose of making a profit?

46. A taxpayer may have more than one purpose for entering into or devising an undertaking or scheme; but for s CB 3 to apply, the purpose of making a profit must be **the** purpose for entering into or devising the undertaking or scheme. This means it must be the "dominant purpose".[25]

47. The focus is on the taxpayer's subjective purpose in entering into or devising the undertaking or scheme; but this is assessed objectively.[26] The taxpayer's purpose is tested when the undertaking or scheme commences,[27] which is when it is clear that the taxpayer has taken an overt step in putting into action a coherent plan formulated earlier.[28] When an undertaking or scheme commences is determined on the facts of each case.[29]

48. When considering the dominant purpose of an undertaking or scheme, it is necessary to consider the subject matter of the undertaking or scheme. For an undertaking or scheme involving subdividing and selling only part of a larger piece of land, the dominant purpose of the undertaking or scheme is tested in relation to the land to be sold.[30] In some cases, the broader factual context in relation to the original, undivided piece of land may help in identifying that dominant purpose.[31]

What is the mere realisation of a capital asset?

49. If a taxpayer owns a capital asset and decides to sell it, taking steps to realise the asset to the best advantage as and when circumstances are favourable is not a profit-making undertaking or scheme.[32] In this regard, it may be relevant to consider factors such as why the asset was acquired, how long it has been held and why, and the nature and extent of the work done to the asset before its sale.

50. While no cases directly discuss what is meant by mere realisation, the Commissioner considers what is relevant is whether the taxpayer is merely disposing of the asset in a way that maximises returns or makes it more attractive to buyers, or whether the taxpayer is creating something new or changing the character of the asset in a

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[25] *National Distributors* at 6,350.

[26] *National Distributors* at 6,351. See also *CIR v Walker* (1961) 13 ATD 108(CA).

[27] *Gilmour v CIR* [1968] NZLR 136 (NZSC); *Case S86* at 7,548.

[28] *Cross & Anor v CIR* (1987) 9 NZTC 6,101 (CA) at 6,106 and 6,111-6,112.

[29] *Smith v CIR* (1987) 9 NZTC 6,118 (CA) at 6,125. See IS 20/08 and QB 15/04 for more detail on when an undertaking or scheme commences.

[30] *Walker* per North J at 123, citing *Bedford Investments Ltd v CIR* [1955] NZLR 978 (NZSC).

[31] *Walker* per North J at 123.

[32] *Beetham* at 6,052.

significant way. Creating something new on the land or making significant changes to its character is not merely realising that asset at best advantage.

51. It has been suggested that s CB 3 cannot apply to the sale of a capital asset, on the basis that such a sale is mere realisation of that asset. Following the Privy Council in *McClelland*, Henry J in *Beetham* stated that what is now s CB 3 does not apply to gains of a capital nature, and it would require a clear statutory provision to bring about such a drastic change in the concept of tax on income.[33] The question as to whether s 26(1) of the Income Tax Assessment Act 1936-1975, an Australian provision similar to s CB 3, could apply to capital gains was later considered by the High Court of Australia in *Whitfords Beach*.[34] Murphy J considered that the Privy Council in *McClelland* had "misunderstood s 26(1) and largely nullified it", and that contrary to the Privy Council's majority view, "s 26(1) has a wide application to capital gains".[35]

52. In the Commissioner's view, references to excluding capital gains in *McClelland* and *Beetham* were directed at the concept of mere realisation of a capital asset at best advantage. If an amount is income under Part C of the Act it is, by definition, not a capital gain. It follows that whether s CB 3 can apply to "capital gains" is not a helpful enquiry. However, if a profit-making undertaking or scheme included the mere realisation of a capital asset, this would function as a very broad capital gains tax, which would not have been intended by Parliament when s CB 3 and its predecessors were implemented.

53. When distinguishing between mere realisation and a profit-making undertaking or scheme, the Privy Council in *McClelland* highlighted that the distinction is whether the transaction has the character of a business deal. This demonstrates that the Privy Council did not intend to exclude all gains flowing from the disposal of a capital asset from the scope of s 26(1).

54. There is some uncertainty as to whether an undertaking or scheme must have the character of a business deal for s CB 3 to apply. This requirement outlined in *McClelland* has been followed in some New Zealand cases but the relevance of it, like other elements of *McClelland*, has been questioned in other cases.[36] However, the Commissioner considers that in any event, many of the factors that would be relevant

[33] *McClelland v FCT* 70 ATC 4115 (PC); *Beetham* at 6,052.

[34] *FCT v Whitfords Beach Pty Ltd* (1982) 39 ALR 521 (HCA).

[35] At 543.

[36] For example, the "character of a business deal" was relied on in *Duff v CIR* (1982) 5 NZTC 61,131 (CA), *CIR v Renouf Corporation Ltd & ors* (1998) 18 NZTC 13,914 (CA), and *Buck v CIR* [1982] 5 NZTC 61,221 (HC), but it was highlighted in *Beetham* and in *Mitchell v CIR* (1987) 9 NZTC 6,033 (HC) that in our legislation, distinct from the Australian legislation at the time, business is expressly provided for. On this basis, Greig J in *Mitchell* observed (at 6,038) the difficulty and danger in relying too closely on authorities based on differently worded sections, and questioned whether this criterion is applicable under New Zealand legislation.

to whether an undertaking or scheme might have the character of a business deal would also be relevant to whether the undertaking or scheme goes beyond the mere realisation of a capital asset. This includes things like the nature of the activity, the scale of operations, the commitment of time, money and effort, and the financial results.[37]

55. While there is some uncertainty about the relevance of the characteristics of a business deal in the context of s CB 3, it is clear that the undertaking or scheme does not need to **be** a business. Therefore, some other factors that are normally relevant when considering whether a business exists are not material in the context of s CB 3, such as the period over which the activity is engaged in, the pattern of activity, and the level of repetition of recurrence. Section CB 3 can apply to an undertaking or scheme even though it lacks the repetitive or recurrent characteristics normally regarded as the hallmark of a business.[38]

56. There is case law support for the view that taking advantage of the subdivision potential of land and selling it in lots is mere realisation of the land at best advantage.[39] This is what the taxpayers did in the *Beetham* and *Eunson* cases, where the subdivisions were straightforward and involved only a survey and incidental steps to give title.[40] This makes sense, as disposing of an asset in parts rather than as a whole should not affect the tax treatment of the disposal.[41] For example, dismantling an old family car to sell its components is just as much the mere realisation of a capital asset as selling the car to a scrapyard would be.

57. However, subdividing land, especially in more recent times, is a much more involved and costly process than in the past. The Commissioner considers that subdivision of land to sell may go beyond mere realisation depending on the amount and nature of the work involved. In *Whitfords Beach*, the High Court of Australia distinguished a development project involving subdivision, construction of roads, the provision of parklands, services, and other improvements, as part of the conversion of undeveloped bush into zoned residential lots, from the simple realisation of a large allotment into several smaller blocks.[42] Wilson J distinguished the facts of the case from others where subdivision was found to be mere realisation on the basis that "a great deal had to be done in order that the land could be sold in residential subdivision. Its character had to undergo significant change".[43]

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[37] Consistent with *Grieve v CIR* (1984) 6 NZTC 61,682 (CA) at 61,691.

[38] *Whitfords Beach* per Mason J at 523.

[39] *Beetham* at 6,052.

[40] *Eunson* at 132.

[41] *Eunson* at 132.

[42] *Whitfords Beach* per Murphy J at 543, per Mason J at 542.

[43] *Whitfords Beach* per Wilson J at 555.

58. Similarly, in the New Zealand case of *Buck*, the subdivision and sale of land was found to be a profit-making undertaking or scheme.[44] The taxpayers in *Buck* purchased a block of land, carried out an extensive project to subdivide and sell most of the land as residential and commercial lots, and retained a section on which they built a house and eight motel units. There were some questions as to whether the first two limbs of s 88(1)(c) of the 1954 Act were satisfied, but Cook J considered it was not necessary to determine that, as the requirements of the third limb (now s CB 3) were satisfied.[45]

59. While not explicitly considering whether the subdivision went beyond mere realisation of a capital asset, Cook J followed *McClelland* and found that the subdivision and development project had the character of a business deal.[46] While, as noted at [54], there is some uncertainty about the relevance in the New Zealand context of the requirement (per *McClelland*) for an undertaking or scheme to have the "character of a business deal", many of the same factors are relevant when considering whether an undertaking or scheme goes beyond mere realisation.

60. It follows that a simple or straightforward subdivision project that involves little work on the land is likely to be mere realisation of a capital asset. Small amounts of development necessary to effect the subdivision are unlikely to change this.[47] On the other hand, a subdivision project that involves constructing one or more new dwellings or buildings on the land would take the undertaking or scheme beyond mere realisation. Other subdivision projects that do not involve building but involve extensive development would also likely go beyond mere realisation, but such a project leading to disposal may well be taxed under a land sale rule such as ss CB 12 or CB 13 in any event.

61. Renovating a house to sell is another potential undertaking or scheme that will often amount to mere realisation at best advantage, but in some circumstances may go beyond mere realisation, depending on the work done. It is common for people to "do up" a house in preparation for sale, to make it more attractive to buyers. For example, replacing fixtures, repainting and recarpeting, or carrying out delayed maintenance or repairs. The Commissioner considers that carrying out this type of renovation to a capital asset in preparation for sale is the mere realisation of that capital asset at best advantage.

62. On the other hand, a complete renovation of a dwelling that significantly changes its character and attributes, or construction of one or more new dwellings or buildings on the land, would be more than mere realisation of the asset. An example of such a renovation is one that involves completely "gutting" the house interior and knocking

[44] *Buck v CIR* [1982] 5 NZTC 61,221 (HC).

[45] *Buck* at 61,224-61,225.

[46] *Buck* at 61,226.

[47] *Scottish Australian Mining Co Ltd v FCT* (1950) 81 CLR 188 at 195.

down multiple interior or exterior walls to change the layout or add significant extensions. This would go beyond mere realisation. Significant development work on the land is also likely to go beyond mere realisation, but disposal of the land in these circumstances is likely to be taxed under ss CB 12 or CB 13.

63. In any case, as addressed from [46], the undertaking or scheme must have been entered into or devised for the purpose of making a profit, so building or complete renovation for any other dominant purpose, such as for the occupants' enjoyment of the land, is outside the scope of s CB 3.

64. These are merely examples, and each case must be considered on its own facts. There is no way to categorically specify the features that would take a subdivision or renovation beyond mere realisation. At the heart of the enquiry is whether the taxpayer is merely preparing a capital asset for sale in a way that maximises returns, or going beyond that to create something new or change the character of the asset in a significant way. That distinction may not always be clear and is a matter of fact and degree.[48]

65. In the interest of clarity, the question of whether work done to maximise returns on sale goes beyond mere realisation is not the same as the distinction between deductible repairs and maintenance expenses and capital improvements. While cases on repairs and maintenance also look at whether the work done changed the character of the asset, the Commissioner considers different factors are relevant when considering whether there has been a change in character in the context of s CB 3. For example, unlike the repairs and maintenance context, whether the work done leads to an improvement is not central to the enquiry.

66. Work done such as re-cladding a leaky house with an improved cladding system would likely change the character of the house and be a capital expense, but the Commissioner considers this would not, in isolation, go beyond mere realisation at best advantage for the purpose of applying s CB 3. Fixing or improving structural or defective elements of an asset are normal and incidental parts of preparing the asset for sale and, in light of the cases discussed above, it is unlikely a court would consider s CB 3 would apply in these circumstances.

Interaction between s CB 3 and exclusions from land sale rules

67. One concern raised about s CB 3 applying to land disposals relates to the fact that there are exclusions from the land rules but there are no exclusions from s CB 3. The concern is that this could mean s CB 3 could apply to a disposal of land that otherwise

[48] *Whitfords Beach* per Wilson J at 4,054, citing *FCT v NF Williams* 72 ATC 4188 at 4,195.

would not be taxed under a land sale rule because of an exclusion, potentially undermining the purpose of those exclusions. However, the Commissioner considers that s CB 3 applying to land disposals does not undermine the exclusions from the land sale rules, as discussed below.

68. The exclusions from the land sale rules are for residential land (ss CB 16 and 17), business premises (ss CB 19 and CB 20), farm land (ss CB 21 and 22), and investment land (s CB 23). These exclusions from the land sale rules apply to exclude from taxation the disposal of land used mainly as a capital asset, either as a residence or to carry on an income-earning activity. Therefore, mere realisation of the asset at best advantage would not result in s CB 3 applying to the disposal. For example, if a house that is not caught by a land sale rule because of one of the residential exclusions is painted before being sold.

69. If more is done to the land, taking the disposal beyond mere realisation of the property at best advantage, the sale is likely to be outside the scope of the exclusion in any event. For example, the residential exclusion in s CB 17(1) applies where work is done in an undertaking or scheme to create or effect a development, division or improvement, but only if the development, division or improvement is for use in or for the purposes of the person and their family residing on the land. A profit-making undertaking or scheme to which s CB 3 applies is not carried on for this purpose, so the exclusion would not be relevant.

70. However, there may be some limited cases where s CB 3 could apply in circumstances where an exclusion to a land sale rule applies.

71. For example, if a person with a business of dealing in land acquired land with a dwellinghouse on it, and occupied the dwellinghouse mainly as a residence such that the residential exclusion in s CB 16 applied, s CB 3 could still apply to the subsequent disposal if, prior to sale, the person demolished the dwelling and built multiple townhouses in its place to maximise returns on sale. This would go beyond mere realisation at best advantage. Similarly, if the person subdivided the land and built townhouses, s CB 3 could apply notwithstanding that the residential exclusion in s CB 17(2) may preclude the relevant land sale rule from applying.

72. The Commissioner considers s CB 3 applying in circumstances such as these does not undermine the exclusions from the land sale rules. This is because the undertaking or scheme does not relate to the person's capital use of the land (eg, in the above examples, their residential use) – which is what the exclusions cover. The undertaking or scheme is separate from the capital use of the land. It is appropriate that the profits from that scheme be taxed, just as they would be had the land not previously been used for a capital purpose.

What if an undertaking or scheme involving land does not go to plan?

73. Section CB 3 refers to an amount derived from "carrying on or carrying out" an undertaking or scheme. This means an undertaking or scheme does not need to be completed, or completed as planned, for s CB 3 to apply to amounts derived in relation to it. Provided there is a sufficient nexus between the undertaking or scheme and any amounts received, s CB 3 may apply even though the amounts did not arise in the manner originally intended at the outset of the undertaking or scheme.[49]

74. For example, in *Duff*, the taxpayers acquired a block of land with the intention of creating a 200-lot subdivision, but before significant progress had been made, the land was compulsorily acquired by the Crown. The Court of Appeal found that the compensation received for the compulsory acquisition was taxable under what is now s CB 3.[50]

75. Woodhouse J observed that, although the undertaking or scheme was not "carried out" in the sense that it was brought to fruition, the resulting compensation was received due to added value prior to the compulsory acquisition, at a time when the scheme was being "carried on".[51] Therefore, the amount received was derived from the carrying on of the scheme to subdivide the land.[52]

If s CB 3 applies to the disposal of land, what deductions are available?

76. Section DB 26 outlines the deduction available if a person derives income under s CB 3 from the disposal of property. The deduction available is the market value of the property immediately after the start of the undertaking or scheme. As stated at [47], an undertaking or scheme starts when the first step in carrying out the scheme takes place.

77. Section DB 26 only applies to an amount derived from the disposal of property if the amount is not income under any provision other than s CB 3.

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[49] *Renouf Corporation* at 13,921, relying on *Duff*.

[50] It is noted that this case concerned the 1954 Act prior to the 1973 amendments, and that ss CB 12 or CB 13 would likely now apply in similar circumstances.

[51] At 61,134.

[52] Per Woodhouse J and Barker J. Cooke J doubted this application but rather than disagreeing, reached the same conclusion by a different route. His Honour stated (at 61,136) that compensation for the loss of a profitmaking scheme, amounts derived from which would have been income, is itself income. On this basis, Cooke J found the compensation was income under ordinary concepts.

78. In addition to the market value of the property, a person can also claim a deduction for things like development or building costs that form part of the "cost" of the property under s DB 23. Deductions may also be available for other costs incurred in the undertaking or scheme, such as borrowing costs and interest under ss DB 5 and DB 6, rates and property insurance under s DA 1, and legal expenses under s DB 62.[53]

Examples | Tauira

Example | Tauira 1 – Building dwelling to live in – Specific land sale rule does not apply due to an exclusion; section CB 3 also does not apply

Sylvia is a builder and the sole shareholder and director of a company that is a Master Builders member and has carried on a building business for clients for over 20 years. Six years ago, Sylvia acquired a block of bare land and built a house on the land. Sylvia lived in the house from the time construction was complete. Sylvia has not previously lived in any of the houses she has built.

Sylvia recently moved to Australia and sold the property.

The sale of the property meets the requirements of s CB 11, as when the improvements began, Sylvia was associated with a company in the business of erecting buildings and the sale is within 10 years of the improvements being completed. However, the residential exclusion in s CB 16 applies, as the house was used by Sylvia as her residence.

Section CB 3 does not apply to the sale, as Sylvia building her house was not an undertaking or scheme carried on with the intention to make a profit. The undertaking or scheme was done for Sylvia to live on the land. The sale is the mere realisation of Sylvia's capital asset.

Example | Tauira 2 – Subdividing and selling bare lot – Section CB 12 applies; section CB 3 may be argued in the alternative but likely does not apply

Elisapeta purchased 10 acres of land seven years ago. She began to build her dream home on the land, but building costs exceeded her expectations and she decided to subdivide the land to help finance the construction. The land was subdivided into one lot of 5 acres with her home on it and one lot of 5 acres to sell.

[53] Up to a maximum of $10,000 for all of the person's legal expenses for an income year. If the total legal fees exceed $10,000 for the year, normal tax rules will apply and capital and revenue amounts must be separately identified.

Elisapeta used the professional services of a surveyor, solicitor and geotechnical engineer. She also organised a landscaper to fence between the two lots and had an earthworks company excavate a driveway to one of the lots. An arborist felled several trees and cleared the site, as this was necessary for the subdivision of the land.

Elisapeta sold the subdivided off 5-acre block of land, which allowed her to complete construction of her home. The proceeds from that sale are taxable under s CB 12 because the subdivision involved development or division work that was more than minor.

It could be argued that s CB 3 applies, as an alternative to the application of s CB 12. But on the above facts it is not likely the work done would go beyond the realisation of a capital asset. The subdivision was relatively straightforward, and work done to effect the subdivision was not extensive. This is not sufficient to change the character of the asset or create something new from it.

Elisapeta may need to provide evidence that, at the time she purchased the land, she did not intend to subdivide and sell some of it, as otherwise s CB 6 may also be relevant to the disposal.

Example | Tauira 3 – Subdividing and building dwelling – No land sale rules apply; section CB 3 applies

Jensen has lived in his home for 12 years. The house and backyard are much larger than he now needs, and he is looking to downsize. Jensen looks into demolishing the existing house, subdividing the land into two, and building two new dwellings, so he can sell one and live in the other. He receives advice that the sale will be highly profitable because he lives in popular area zoned for multiple good schools.

Jensen arranges for the land to be subdivided and engages architects and contractors to design and construct the houses. Each is a two-storey, three-bedroom dwelling. After demolition and construction, Jensen moves into one house and sells the other.

Section CB 12 does not apply as the undertaking or scheme was not commenced within 10 years of Jensen acquiring the land. It is assumed for the purposes of this example that s CB 13 does not apply to the sale because the development work is largely preliminary to building work and does not meet the significant expenditure threshold.

However, subdividing the property to create a new section to build a house on to sell is a profit-making undertaking or scheme to which s CB 3 applies. Constructing a new dwelling to sell creates something new on the land, and completely changes its

character. This goes beyond merely realising part of his land at best advantage. While Jensen continues to live on the other section in his new home, his dominant purpose is tested in relation to the part of the land sold. His dominant purpose of subdividing to create a new section and building the second dwelling was to profit from its sale.

Jensen is entitled to deductions for:

- the market value of the part of the land being sold immediately after the start of the undertaking or scheme (under s DB 26);
- the development and building costs that form part of the "cost" of the property (under s DB 23);
- other costs incurred in the undertaking or scheme, such as interest, rates, property insurance, and legal expenses[54] (under ss DA 1, DB 6 and DB 62).

Example | Tauira 4 – Subdividing and selling multiple lots – Sections CB 12 and CB 13 do not apply and neither does section CB 3; section CB 3 may apply with alternative facts

Nic has owned a large property for over 20 years and has decided to downsize. To maximise returns from the sale of the property, Nic decides to subdivide the land and sell it as four separate lots.

As a condition of the subdivision consent, the council required Nic to construct an entranceway to the subdivided lots. The development work required by the council was straightforward and the cost to complete it was minimal.

Section CB 12 does not apply as the undertaking or scheme was not commenced within 10 years of Nic acquiring the land. Section CB 13 does not apply because the development work does not meet the significant expenditure threshold.

Section CB 3 does not apply to the mere realisation of a capital asset. Dividing the land into lots is merely realising the capital asset at best advantage. Nic has simply divided the asset into smaller parts to sell at a higher price. While there was some development work required by the council for consent, this work was straightforward with minimal cost. It is not enough to take the subdivision beyond mere realisation at best advantage.

However, if Nic had decided to construct dwellings on the subdivided lots to profit further from the venture, this would be an undertaking or scheme to which s CB 3

[54] Up to a maximum of $10,000 per income year (for all legal expenses, not just those relating to the undertaking or scheme).

could apply. The construction of multiple extra dwellings goes far beyond merely realising the land at best advantage. Constructing dwellings creates something new on the land, and completely changes its character. At this point, the undertaking or scheme could no longer be described as merely realising an asset at best advantage.

Example | Tauira 5 – Acquiring land with purpose or intention of disposal – Specific land sale rule applies; section CB 3 can also apply in the alternative

Sam owns land on the outskirts of a growing town that he purchased to live on. After living there for several years, Sam becomes aware that a property developer is looking for a large block of land in the area for a new development. Sam acquires a neighbour's farm, with the intention of selling both blocks of land to the property developer for a profit.

Section CB 6 applies to the amount Sam derives from disposing of the land that was the neighbour's farm, as Sam acquired that land with the intention of disposing of it.

The requirements of s CB 3 are also satisfied for the sale of the neighbour's farm, as Sam derived an amount from a profit-making undertaking or scheme. The purchase and sale of the neighbour's farm involves a series of steps directed to an end result, which is to make a profit from the sale of land acquired for that purpose.

The amount is not derived from the mere realisation of a capital asset, as Sam acquired the neighbour's farm intending to dispose of it as part of the undertaking or scheme. It is not a capital asset that Sam is merely disposing of at best advantage. However, as a relevant land sale rule applies, the disposal should be taxed under s CB 6, rather than s CB 3.

The sale of Sam's original land is not subject to tax under either provision.
Section CB 6 does not apply as the land was not acquired for a purpose or with an intention of disposal. Section CB 3 does not apply as the amount was derived from the mere realisation of a capital asset.

Example | Tauira 6 – Complete renovation and extension – None of the land sale rules apply; section CB 3 applies

Shannon owns a house in a central suburb near a university. Shannon bought the house 15 years earlier to rent out. The house is a 120m^2 two-bedroom house with one bathroom. The house sits on a larger plot of land that Shannon thinks is under-utilised.

Shannon plans to sell the house, but she thinks she could make much more if she completely renovated it and added an extension and more rooms, to make it more attractive as student rental accommodation. In addition, the house has a quirky layout that Shannon thinks is an inefficient use of space, and might make it unattractive to buyers. Shannon consults a friend who has done a lot of residential development and renovation, and they advise that she could get much more for the house if the space were used more efficiently and if it had more bedrooms, particularly with the university nearby.

Shannon engages the services of architects, engineers, and contractors to arrange and carry out complete renovation of the house, and the addition of a new wing with two new bedrooms, a laundry, and an additional bathroom. She obtains resource and building consent from the council.

The renovation of the existing part of the house involves knocking down and altering multiple interior walls to make the kitchen and lounge open plan, and converting the two existing bedrooms, walk-in wardrobes, and parts of the existing hallways and lounge into three smaller bedrooms more suitable for students. It also involves adding additional windows and extending the existing deck along one side of the house, complete refits of the kitchen and bathroom, and recarpeting and painting of the entire interior. The exterior is also repainted, and the shingle roof is replaced with painted corrugated steel. The renovated house is 250m^2 with five bedrooms and two full bathrooms. The interior layout and most of the fittings have completely changed.

Shannon sells the renovated house for a profit. None of the land sale rules will apply to the disposal. This includes s CB 12, as Shannon owned the property for more than 10 years. Section CB 13 is also not relevant, as the development work involved does not meet the significant expenditure threshold, and is largely preliminary to building work, like levelling and foundation work for the extension.

However, the renovation is a profit-making undertaking or scheme as it is a project devised to attain maximum profit from the sale of the land, with a coherent plan or purpose involving several steps directed to that end.

The sale is not the mere realisation of a capital asset, as completely renovating and changing the fundamental attributes of the house goes beyond merely realising the asset at best advantage. The commitment of time, money and effort, and the financial results are consistent with this and with the undertaking or scheme having the character of a business deal, even though it is unlikely to amount to a business due to its limited scale and one-off nature.

For these reasons, s CB 3 applies to the sale of Shannon's house. Shannon is entitled to deductions for:

- the market value of the property immediately after the start of the undertaking or scheme (under s DB 26);
- the development and building costs that form part of the "cost" of the property (under s DB 23);
- other costs incurred in the undertaking or scheme, such as interest, rates, property insurance, and legal expenses[55] (under ss DA 1, DB 6 and DB 62).

Example | Tauira 7 – Less extensive renovation – Section CB 3 does not apply

The facts are the same as in Example | Tauira 6, except that Shannon carries out a less extensive renovation. After 15 years, the house is somewhat rundown, and Shannon wants to spruce it up by renovating it for sale.

Shannon engages contractors to renovate the bathroom and kitchen. The toilet, shower, and bathroom fittings are all replaced. The renovation also involves knocking down the interior wall between the kitchen and lounge to make the living area open plan, as Shannon understands open-plan living spaces are more attractive to buyers. A new, larger kitchen is installed with more storage, increased bench space, an integrated cooktop, and splashback tiles. The vinyl flooring in the bathroom and kitchen is removed and replaced with tiling.

Shannon also has some of the windows and windowsills replaced due to high moisture levels, has the curtains replaced with blinds, recarpets the house, and she repaints inside and out.

Shannon sells the renovated house for a profit. As with Example | Tauira 6, none of the land sale rules will apply to the disposal.

Section CB 3 will also not apply to the disposal. While Shannon renovated the house to maximise profit, the work done does not go beyond mere realisation at best advantage. While the work done has improved the house, it does not significantly change the character of the house or involve creating something new on the land. The house is still a two-bedroom house with the same footprint and largely the same features. The renovation was done due to the house being somewhat neglected over 15 years and forms an incidental part of preparing the land for sale.

[55] Up to a maximum of $10,000 per income year (for all legal expenses, not just those relating to the undertaking or scheme).

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