

## QUESTION WE'VE BEEN ASKED QB 15/02

### INCOME TAX – MAJOR DEVELOPMENT OR DIVISION – WHAT IS “SIGNIFICANT EXPENDITURE” FOR SECTION CB 13 PURPOSES?

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Question We've Been Asked is about s CB 13.

#### Question

1. What expenditure is taken into account for s CB 13 purposes, and when will such expenditure be regarded as “significant”?

#### Answer

2. Expenditure on the following **is** taken into account for s CB 13 purposes:
  - channelling, contouring, drainage, earthworks, kerbing, levelling and roading;
  - other physical developmental work that is customarily found in major projects involving development of land for commercial, industrial or residential purposes (for example, paving, retaining, sewage piping, power cabling, demolition and site clearing); and
  - other non-physical developmental work that is customarily found in major projects involving development of land for commercial, industrial or residential purposes (for example, preparation of zoning applications, the drawing of engineering plans and specifications, and the provision of estimates).
3. The following **is not** taken into account for s CB 13 purposes:
  - non-developmental work;
  - the value of a **person's time, effort** or use of their machinery or other equipment in undertaking the development work; and
  - future expenditure not yet incurred on the undertaking or scheme.
4. Whether expenditure on the undertaking or scheme is significant for s CB 13 purposes requires consideration of:
  - the amount of the expenditure in absolute terms;
  - the amount of the expenditure relative to the pre and post development value of the land; and
  - the context of the project.
5. Whether the total amount of relevant **expenditure is “significant” for s CB 13** purposes will be a matter of fact and degree in the circumstances of any given case, bearing in mind that the focus of the provision is major projects.
6. This item qualifies IG0010 **“Work of a minor nature” Tax Information Bulletin** Vol 17, No 1 (February 2005): 5 in one respect. IG0010 is regarded as incorrect to the extent that it suggests **that only physical work can be “development” work**. On this point, see further from [23].

## Explanation

7. An amount is income of a person under s CB 13 (provided the amount is not income under any of ss CB 6 to CB 12 and CB 14) if it is derived by them from disposing of land in circumstances where:
  - an undertaking or scheme (not necessarily in the nature of a business) is carried on by the person (or by someone for them);
  - the undertaking or scheme involves the development of the land or the division of the land into lots; and
  - the development or division work involves significant expenditure on channelling, contouring, drainage, earthworks, kerbing, levelling, roading, or any other amenity, service, or work customarily undertaken or provided in major projects involving the development of land for commercial, industrial, or residential purposes.
8. There are a number of exclusions from s CB 13: the residential exclusions (s CB 17), the business exclusion (s CB 20), the farm land exclusion (s CB 21) and the investment exclusion (s CB 23). This item does not cover the application of the exclusions.
9. Normally a person is allowed a deduction for expenditure they incur as the cost of revenue account property (s DB 23). However, when a person derives income under s CB 13, s DB 27 allows a deduction for the value of the land at the time the undertaking or scheme commenced. As a result, when s CB 13 applies, the increase in the value of the land from the time the undertaking or scheme is commenced until the land is disposed of is taxed.
10. The question we have been asked requires consideration of:
  - what expenditure is taken into account for s CB 13 purposes; and
  - **when expenditure will be "significant"** for s CB 13 purposes.

## Legislation

11. Section CB 13 provides (relevantly) as follows:

**CB 13 Disposal: amount from major development or division and not already in income**

*Income*

- (1) An amount that a person derives from disposing of land is income of the person if—
  - (a) the amount is not income under any of sections CB 6 to CB 12 and CB 14; and
  - (b) the amount is derived in the following circumstances:
    - (i) an undertaking or scheme, which is not necessarily in the nature of a business, is carried on; and
    - (ii) the undertaking or scheme involves the development of the land or the division of the land into lots; and
    - (iii) the person, or another person for them, carries on development or division work on or relating to the land; and
    - (iv) **the development or division work involves significant expenditure on channelling, contouring, drainage, earthworks, kerbing, levelling, roading, or any other amenity, service, or work customarily undertaken or provided in major projects involving the development of land for commercial, industrial, or residential purposes.**

...

[Emphasis added]

## Application of the legislation

12. As can be seen, s CB 13(1)(b)(iv) is the relevant paragraph of the provision here. That paragraph requires that the development or division work involves significant expenditure on:
- channelling, contouring, drainage, earthworks, kerbing, levelling, roading, or
  - any other amenity, service, or work customarily undertaken or provided in major projects involving the development of land for commercial, industrial, or residential purposes.
13. The following discussion considers the issue of **what expenditure** is taken into account for s CB 13 purposes, followed by the issue of **when expenditure will be "significant"** for s CB 13 purposes.

### **What expenditure is taken into account for s CB 13 purposes?**

14. The first issue raised is what expenditure is taken into account for s CB 13 purposes. A number of sub-issues arise from this question, namely:
- Is the **"any other amenity, service, or work ..."** category limited to things of the same type as the specifically listed works? If so, what things will be in that category?
  - Is it only work found solely in major projects that is relevant, or is work that is found in both major and non-major projects included?
  - Does the work have to be undertaken or provided in the context of an industrial, commercial or residential development?
  - **Is a person's time and the use of their own machinery taken into account?**
  - Is intended future expenditure on the undertaking or scheme taken into account?

These are considered in turn below.

### ***Is the "any other amenity, service, or work ..." category limited to things of the same type as the specifically listed works? If so, what things will be in that category?***

15. As can be seen at [11], some specific works are referred to in s CB 13(1)(b)(iv) – channelling, contouring, drainage, earthworks, kerbing, levelling, roading. All of the works in this specific list involve physical development work on the land. However, the provision then includes the more general phrase **"or any other amenity, service, or work customarily undertaken or provided in major projects involving the development of land for commercial, industrial, or residential purposes"**. **The first issue for consideration is what is included within that phrase.**
16. The *ejusdem generis* principle of statutory interpretation may assist with this issue. The *ejusdem generis* principle directs that **"if the specific words in the list are of the same class, the general word following them is construed as also being limited to that class"** (J F Burrows and R I Carter, *Statute Law in New Zealand* (4th ed, LexisNexis, Wellington, 2009) at 233).
17. Nothing suggests that s CB 13(1)(b)(iv) should not be read in line with the *ejusdem generis* principle<sup>1</sup>. Applying this principle means that the wide words **("any other amenity, service or work ...")** in s CB 13(1)(b)(iv) should be read as limited to works within the same class as the specifically listed works.

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<sup>1</sup> See *Skycity Auckland Ltd v The Gambling Commission* [2007] NZCA 407, [2008] 2 NZLR 182 on the requirements that must be satisfied for the principle to be applied.

18. However, there are different possible interpretations of what class the list of specific words form. “Channelling, contouring, drainage, earthworks, kerbing, levelling and **roading**” could be seen as all being works that are:
- physical development work on the land; or
  - developmental work, as opposed to things that are purely division work.
19. The Commissioner considers the better view is that the class of specific works in s CB 13(1)(b)(iv) should be regarded as being developmental works, as opposed to purely divisional. The Commissioner does not consider that the class of works is limited to physical developmental works. In particular, the Commissioner notes that s CB 13 refers to work on or relating to the land. This suggests that developmental work other than physical developmental work on the land was intended to be included in the significant expenditure determination. Similarly, the fact that s CB 13 **refers to any other “service” (and to a lesser extent “amenity”) in addition to any other “work” on or relating to the land suggests that non-physical developmental work should be included.**
20. Accordingly, applying the *ejusdem generis* principle would mean that the wider **“or any other amenity, service or work ...” words would encompass other physical developmental work not already listed (such as paving, retaining, sewage piping, power cabling, demolition and site clearing) and other developmental work that is not physical work on the land (such as preparation of a zoning application, the drawing of engineering plans and specifications, and the provision of estimates).** The application of the *ejusdem generis* principle would exclude from consideration any work that was purely division work on or relating to the land (such as surveying that is related to the division of the land, as opposed to surveying related to development of the land, and the preparation and deposit of subdivision, unit title or flats plans).
21. The Commissioner notes that in the two relevant cases on what is now s CB 13, *Aubrey v CIR* (1984) 6 NZTC 61,765 (HC) and *Mee v CIR* (1988) 10 NZTC 5,073 (HC), survey costs were taken into account. However, the taxpayer in *Aubrey* had accepted that these costs were to be included. In *Mee*, the taxpayer submitted that the survey costs should not be taken into account, based on observations of Ongley J in *Wellington v CIR* (1981) 5 NZTC 61,101 (HC) (a case concerning what is now s CB 12). In that case, Ongley J had expressed the view that **“development or division work” in what is now s CB 13 encompassed only things that were developmental in nature.** In *Mee*, Hardie Boys J, while noting the decision in *Aubrey*, indicated that he tended to share Ongley J’s view. Hardie Boys J did not need to decide whether survey fees should be included in the context of the *Mee* case, as the outcome would not have differed. For the reasons discussed above, the Commissioner considers that expenditure for work that is purely division work should not be taken into account.
22. **It is noted that “development” in the context of s CB 13 means development in the sense of the preparation of the land for an intended use. It does not include the construction or erection of buildings (*Dobson v CIR* (1987) 9 NZTC 6,025 (HC)).**

#### **Qualification to IG0010 “Work of a minor nature”**

23. IG0010 **“Work of a minor nature” Tax Information Bulletin** Vol 17, No 1 (February 2005): 5, at 9-10, states that development work entails some form of physical work being undertaken in relation to the land. The Commissioner no longer considers that statement to be correct. *Smith v CIR (No 2)* (1989) 11 NZTC 6,018 (CA) makes it clear that development work does not have to be physical work. As McMullin J stated at [6,024-6,025]:

What then is meant by the words "development or division into lots". There is a degree of overlapping in that phrase. Some development work may not be division work and vice versa, but generally speaking the two will go hand in hand. "Division" is not defined in the *Land and Income Tax Act* or the *Local Government Act* 1974 which deals with the subdivision of land. "Development" is also not defined. This rather suggests that the framers of the tax legislation intended that the phrase "development or division" is not to be narrowly construed when considered in relation to an undertaking or scheme. By declining to define "development or division work" sec 88AA(d) leaves the exact nature of the work wide open. **Development work frequently involves physical work on the land itself but need not necessarily do so.** In their concession that the letting of the sewage contract in October 1971 was capable of construction as a development work, counsel for the appellant rightly recognised that a contractual step which anticipates physical work but itself falls short of it may be development work. In my view development work on a subdivision of land may cover a range of activities including, in appropriate cases, the preparation of a zoning application without which the subdivision and resulting sales at a profit could never be achieved, the drawing of engineering plans and specifications for roads, the provision of estimates, the preparation of subdivisional plans, the letting of the necessary contracts and the resulting physical work involving the construction of roads, rights of way and culverts.

[Emphasis added]

24. Similarly, Bisson J stated at [6,026]:

If he [counsel for the taxpayer] accepts as a matter of law that legal work can be division work in a scheme involving division into lots, there can be no justification as a matter of law and logic for not accepting legal work as development work in a scheme involving development. This would also be the case if the scheme involved both development and division into lots of the land in question.

25. On the basis of this Court of Appeal authority, the Commissioner considers that IG0010 incorrectly suggests **that only physical work can be "development" work.** IG0010 **no longer represents the Commissioner's view in this regard.**

*Is work found in both major and non-major projects included?*

26. It has been suggested that only categories of work that are found in major projects but not also in minor projects are relevant for s CB 13 purposes. This view is based on the fact that the focus of s CB 13 is major projects, and the list of specific works in the section is intended to distinguish s CB 13 from s CB 12. It has been suggested that to include categories of work that are also found in minor projects would undermine this distinction.
27. The Commissioner does not agree that only categories of work found in major projects, not those found in both major and minor projects, are included in the significant expenditure determination. The categories of work specified in s CB 13 are not things that are exclusive to major projects. Earthworks, drainage, contouring, channelling, levelling, etc may be undertaken in both minor and major projects. What is telling, in terms of whether s CB 13 applies, is whether the expenditure on all of the work included in the provision is significant. If the expenditure on such work is significant, that means the project is sufficiently major to attract the application of s CB 13.

*Does the work have to be undertaken or provided in the context of an industrial, commercial or residential development?*

28. For s CB 13 to apply, the amenity, service or work does not need to be undertaken in the context of a commercial, industrial or residential development. The amenity, service or work only needs to be of a type **customarily** undertaken or provided in major projects involving the development of land for commercial, industrial or residential purposes.
29. It has been suggested that to be relevant for s CB 13 purposes the level of expenditure on any of the specific works listed in s CB 13 must be such as one would customarily find in major projects involving development for industrial, commercial or residential purposes. Alternatively, it has been suggested that the

expenditure on any of the specific works will only be included if the work undertaken is of a kind or scale that might occur in major projects involving development for industrial, commercial or residential purposes.

30. All of the specific works mentioned in s CB 13 **are** customarily undertaken or provided in major commercial, industrial or residential development projects. The expenditure on, or scale of, such work does not need to be what would customarily be found in such major projects. Rather, **all** of the expenditure on such works is relevant, together with any expenditure on work that falls within **the "catch-all" wider words in the provision (which must be work customarily undertaken in major projects involving development for commercial, industrial or residential purposes, as the specifically listed items are)**. It is necessary to ascertain whether the totality of this expenditure is significant. The **Commissioner's view is that the** expenditure on work in any particular category does not need to be significant, or at a level one might customarily find in major commercial, industrial or residential developments, to be included in the significant expenditure evaluation.

***Does a person's time, effort and use of their own machinery need to be taken into account?***

31. In both *Aubrey* and *Mee*, the court **considered that the taxpayers' time** (and the **taxpayer's family's time in *Aubrey***) was relevant in assessing whether the expenditure was significant. In both cases, the use of the **taxpayer's** own machinery was also considered to be relevant. In *Aubrey*, Tompkins J noted that the expenditure of time and the use of machinery could not be quantified in monetary terms, but were nonetheless relevant. In *Mee*, Hardie Boys J made a monetary allowance (which equated to \$306) for the **taxpayer's time and the use** of his machinery.
32. The Commissioner does **not consider that a taxpayer's** (or other person's) time, effort or use of their machinery or other equipment is a relevant consideration for s CB 13 purposes. If it were intended that non-monetary expenditure be taken into account, the provision could simply have stipulated that it applied where the development or division involved major or significant work on the specified activities (or any other work, etc). The fact that s CB 13 requires that **"the development or division work involves significant expenditure" (emphasis added) suggests that "expenditure" was meant to mean something other than simply** work or the use of energy or other resources. The Commissioner considers that **"expenditure" in s CB 13** should be read in the sense it is generally used in taxing statutes—an outlay of a monetary sum. Whether the expenditure needs to be incurred at the time an amount is derived from any given disposition of land is discussed below.
33. Although **the taxpayer's labour (or the unpaid labour of others)** is not relevant for determining whether there was significant expenditure, any expenditure on labour, including payments to working owners / working partners etc for services performed, should be taken into account for s CB 13 purposes.
34. Although the use of **a taxpayer's** machinery is not relevant for determining whether there was significant expenditure, there may be some associated expenditure that is relevant, for example, the cost of fuel used in the machinery, as this is monetary expenditure. Similarly, expenditure on the purchase or hire of machinery or other equipment would be relevant. In the case of the purchase of machinery or equipment, it may be appropriate to apportion the expenditure to reflect the use related to the undertaking or scheme.

*Is future expenditure not yet incurred on the undertaking or scheme taken into account?*

35. Another issue sometimes raised is whether intended future expenditure on the undertaking or scheme should be taken into account, or just expenditure that has been incurred at the time an amount is derived from the disposition of the land in question.
36. Section CB 13 is concerned with the development or division work of the undertaking or scheme, not just that carried out in relation to a particular piece of land involved in the undertaking or scheme. Some of the development or division work may be yet to occur at the time an amount is derived from the disposition of a particular piece of land. The **provision's** focus being on the work of the undertaking or scheme may arguably suggest that intended future expenditure on development or division work that is part of the undertaking or scheme should be taken into account. However, the wording of s CB 13 does not make clear whether all of the expenditure related to the undertaking or scheme should be taken into account, even if it has not been incurred at the time an amount is derived from the disposal of some of the land.
37. Prior to the Income Tax Act being rewritten for improved clarity (which was done progressively from 1994), s CD 1(2)(g) of the Income Tax Act 1994 (as it then was) referred to development or division work (being work involving significant expenditure on the specified things) that **"has been carried on or carried out"**. This earlier wording of the provision tends to indicate that what should be taken into account is only expenditure that had been incurred at the time an amount is derived from the disposal of the land in question.
38. Section YA 3 of the Income Tax Act 2004 and s ZA 3 of the Income Tax Act 2007 set out transitional provisions relating to the rewrite of the Act, and they stipulate that the rewritten provisions were intended to have the same effect as the corresponding provisions in the ITA 1994 and ITA 2004 respectively (unless the subject of an identified policy change, or subsequently amended).
39. What is now s CB 13 was not specified in Schedule 22A of the ITA 2004, and is not listed in Schedule 51 of the ITA 2007. Therefore, the provision was not the subject of any intended policy change as part of the rewrite, and it was intended to have the same effect as the corresponding provision in the ITA 1994. As is clear from the provision as it was in the ITA 1994, the development or division work had to **have been** carried on or carried out at the time an amount is derived from the sale or disposition in question.
40. The Commissioner therefore considers that intended future expenditure on the undertaking or scheme should not be taken into account; only expenditure that has been incurred at the time an amount is derived from the disposition of the land in question is relevant to whether that amount is income under s CB 13.

***When will expenditure be "significant" for s CB 13 purposes?***

41. The second of the two main issues arising is when expenditure will be regarded as **"significant" for s CB 13 purposes**. As noted above, the question is whether the totality of the relevant expenditure is significant, not the expenditure in any given category.
42. In *Aubrey*, Tompkins J noted that the circumstances of a particular case will determine whether expenditure is significant, and that it is a matter of fact and degree.
43. The taxpayer in *Aubrey* had some coastal farm land. There was a settlement of some 50-60 families who resided on part of the land in consideration for a small amount of rent. The taxpayer decided to subdivide off that part of the farm land.

He prepared (and the county council approved) a scheme plan for 105 residential sections on approximately 17 acres, together with roadways, access ways and an esplanade reserve. The work that was required to effect the subdivision included: the grassing of sand to prevent erosion, the installation of stormwater drainage, some roading, the boxing and concreting of manholes, and the electricity (which had been brought to the area prior to the subdivision) being extended.

44. The total cost of materials supplied and work done by contractors was \$20,280 (in 1967 dollars). **This included surveyor's costs, insurance and legal expenses.** The taxpayer also undertook some work himself. The county engineer at the time described the **county's conditions of approval as very low by the then current standards.** The roads were not sealed, there was no kerbing, channelling, water or sewerage, and the depth of metal required on the roadway was minimal.

45. In finding that the expenditure in *Aubrey* was significant and that s CB 13 therefore applied, Tompkins J commented at [61,770]:

In weighing up whether the work involved expenditure that was significant, I have had regard to the size of the resulting subdivision (105 sections), the nature and extent of the physical work carried out as described in the evidence, the value of the land that resulted from the expenditure (\$168,000), and the circumstances and location of the subdivision and the standards considered appropriate. In doing so I have not found it helpful to use dictionary definitions to translate **"significant expenditure" into other words.** I prefer to consider those words in their plain and ordinary meaning.

Having done so, I am satisfied that the expenditure was significant in the contexts to which I have referred. It resulted in the completion of a relatively large subdivision. That involved some considerable roading and the formation of rights of way. It also required the provision of stormwater drainage. Ignoring the expenditure of time and equipment by the objector, \$20,280 is 12% of the resulting value of the land. It would be a considerably higher proportion of the pre subdivision value. In my opinion, viewed in relation to a seaside holiday subdivision requiring only modest subdivisional standards, an expenditure in 1967 of \$20,280 or in 1983 of \$109,620 (both increased by the value of the objector's work and machinery) can hardly be regarded as insignificant.

46. The fact that Tompkins J had regard to the context of the subdivision (in particular the modest standards imposed on it) has been criticised by some<sup>2</sup>. However, the Commissioner agrees with **Tompkins J's point that expenditure at the level it was, in the context of a development project that did not have very high standards imposed on it, emphasises the significant nature of the expenditure.** That is, the expenditure in absolute and relative terms was even more starkly significant when one considered that the development project did not have very high standards imposed on it. With lower than typical standards one would expect lower expenditure in absolute and relative terms than what was incurred by the taxpayer in *Aubrey*. The Commissioner agrees that the context can be informative as to how significant the expenditure is.

47. The present-day regulatory context, including the existence of the Resource Management Act 1991, may mean that, in absolute terms, the expenditure on an undertaking or scheme of development is higher (accounting for inflation) than it would have been historically. The existence of higher regulatory standards may also mean that expenditure relative to at least the pre-development value of the land may be less likely to be regarded as significant than such relativities might have suggested historically, when such standards were not imposed. However, the increased costs associated with the current regulatory environment would, generally speaking, be expected to be reflected in property values. As such, expenditure relative to post-development values may not be significantly altered by higher current day regulatory standards. It may be that the context in which some expenditure related to regulatory requirements arises is a relevant consideration for s CB 13 purposes. For example, if someone had to deal with a

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<sup>2</sup> See, for example, John Prebble, *Taxation of Property Transactions* (Butterworths NZ Ltd, Wellington, 1986) at [§12.6].

particularly litigious party in the Environment Court and the development costs were therefore more than would usually arise for a similar development project, that might be a relevant contextual consideration in assessing whether the overall expenditure was significant.

48. The other case that concerned whether expenditure was significant for s CB 13 purposes is *Mee*. The taxpayer in that case had been farming a property in Queenstown. A 2-hectare strip of the land was unsuitable for farming, so the taxpayer decided to subdivide it into 22 sections for sale. The road adjacent to the land was unsealed at the time, and there was no water or sewerage reticulation. The local authority consented to the subdivision subject to some conditions. The taxpayer had to enter into a contract to pay the council half of the estimated costs of additional roading being formed and the length of the road that fronted the subdivision being sealed. Further, the taxpayer had to enter into a contract to pay \$580 per section towards the cost of providing water and sewerage services to the sections (which the council would install in the future as necessary). The taxpayer also had to create access ways to some of the sections, provide storm water drainage and provide necessary easements.
49. Hardie Boys J accepted that the payment to the council for the future roading, water and sewerage should not be taken into account in this case. This was because that **work, if and when ultimately done, would not be "carried on or carried out by or on behalf of the taxpayer on or in relation to the land"**.
50. It is noted that the payments to the council in *Mee* were to cover the cost of the work if and when the council deemed it necessary in the future. In a situation where a taxpayer paid a council or other authority for some services or work being provided, that expenditure would be relevant for s CB 13 purposes.
51. Other council contributions such as development contributions for additional community and network infrastructure would not be taken into account for the purposes of s CB 13. Such contributions typically go towards the cost of public infrastructure that is needed to meet the additional demands arising from the population growth in an area—for example transport, open space reserves, and community facilities. Similarly to the local authority fees in *Mee*, such contributions would not be for work to be done on behalf of the taxpayer.
52. In *Mee*, Hardie Boys J considered that, at most, the relevant costs were: the survey fees (\$2,647), the valuation fees (\$617), the cost of pipes and gravel for the formation of the access ways (\$180), and an allowance for the use of the **taxpayers' machinery and for the value** of the time he spent on physical work on the land (\$306)—a total of \$3,750. [As discussed above, the Commissioner considers that division costs should not be taken into account, and neither should **the taxpayer's labour or the use of their machinery**. Hardie Boys J included the survey fees, but noted that he tended to think they should not be taken into account. However, he did not need to decide the matter in *Mee* as the outcome did not turn on this.]
53. Hardie Boys J found that the expenditure of \$3,750 was not significant in terms of what is now s CB 13, noting that the statutory emphasis was on major projects. He considered the amount of expenditure in absolute terms, and also relative to the number of sections, and to the value of the land pre and post division. Hardie Boys J commented as follows at [5,077]:

In *Aubrey, Tompkins* J considered that the decision as to whether the relevant expenditure was significant in terms of para (e) had to be based inter alia on its relativity to the nature of the subdivision and the value of the completed project. It must always be a matter of fact and degree in the individual case, but nonetheless it must be remembered that the statutory **emphasis is on "major projects"**. I therefore doubt that expenditure of \$3,750 (even in 1974 terms) could in any circumstances be regarded as significant. It plainly is not so when it is related to the other information that is available here. Divided amongst 22 sections, it amounts

to \$170 per section. The land as a block before subdivision was valued at \$185,000 as at August 1973. The relevant expenditure was some 2% of that. By April 1977 14 sections had been sold, the average net proceeds being a little over \$12,000. The expenditure per section was thus 1.4% of the average price. On any approach, the expenditure cannot in my opinion be regarded as significant.

54. The Commissioner considers that, on the basis of *Aubrey* and *Mee*, it is clear that **whether expenditure is "significant" for s CB 13 purposes will be a matter of fact and degree in the circumstances of any given case.**
55. In terms of how much expenditure will **be regarded as "significant" for s CB 13 purposes**, it must be borne in mind that the statutory emphasis is, as noted by Hardie Boys J in *Mee*, on major projects. The **provision's focus on major projects colours the level of expenditure that will be regarded as "significant"**. That said, the Commissioner considers that the extent of the expenditure still needs to be considered. **There is no "threshold question" of whether a project is "major"**; the amount of the expenditure is what determines whether a project is sufficiently major to fall within s CB 13.
56. Section CB 12 also provides some indication as to what significant may mean in s CB 13. Undertakings or schemes that involve development or division work that is not minor will be caught by s CB 12 if commenced within 10 years of acquisition of the land in question. The different levels of work or expenditure required to fall within ss CB 12 and CB **13 further indicate that "significant" in s CB 13 was intended to be reasonably high, and what is not significant in terms of the provision is therefore reasonably high too.**
57. Consideration of the amount of the expenditure relative to the pre and post development value of the land indicates how substantial the project is, and therefore whether the expenditure should be regarded as significant for s CB 13 purposes. It may well be that the amount of expenditure in absolute terms is sufficiently high that it could only be regarded as significant, even though in relative terms it would not seem significant. Similarly, it may well be that the expenditure in relative terms appears significant, but when considered in absolute terms, and in the context of the project, it would not be regarded as significant.
58. It is impossible to draw definitive lines in terms of absolute amounts or relative percentages of expenditure to land value. Whether expenditure is significant for s CB 13 purposes will be a matter of fact and degree in the circumstances of any given case.
59. The nature and extent of the physical work carried out as part of the undertaking or scheme would indicate whether the project was a major one. However, s CB 13 is concerned with whether the expenditure is significant. The Commissioner considers that the nature and extent of the physical work is not instructive in that regard. That said, if the extent of the physical work carried on is suggestive of the project being a major one, typically that will go hand in hand with associated significant expenditure. However, this will not necessarily be the case—for example, where someone undertakes extensive physical development work on their land themselves without incurring a great deal of expenditure.

## Examples

60. The following examples are included to assist in explaining the **"significant expenditure" requirement of s CB 13**. They do not consider any of the other requirements of s CB 13, including the requirement in s CB 13(1)(a) that the amount derived on the disposition is not income under any of ss CB 6 to CB 12 and CB 14. The examples also do not consider the potential application of any of the exclusions to s CB 13, or of any other potentially applicable provisions.

### **Example 1 – Significant expenditure and progressive sales during a project**

61. The G Family Trust owned some land near Hamilton, which had been farmed by the G family for three generations. None of the G family children wished to take over the farm, so the trust decided to subdivide the land into 18 equal-sized lifestyle blocks. Carrying out the scheme involved expenditure of approximately \$200,000 on earthworks and metalling related to the creation of rights of way to the subdivided blocks. Approximately \$100,000 was incurred on surveying and legal expenses related to the delineation of the boundaries of the new blocks. The land was valued at \$1.4m prior to the subdivision, and the 18 lots sold for a total of \$2.3m. The first three lots were sold (for a total of \$350,000) early on in the course of the project, as they did not require the rights of way for access. At the time the sales of those lots settled, only \$10,000 had been incurred on the earthworks. By the time the remaining lots were sold, all of the work had been completed.
62. The relevant expenditure for s CB 13 purposes totals \$200,000—being the expenditure on the earthworks and metalling related to the creation of the rights of way. The expenditure on the survey and legal fees related to the delineation of the boundaries is not relevant expenditure for s CB 13 purposes, as it is not developmental work.
63. When the sales of the first three lots settled, \$10,000 of relevant expenditure had been incurred on the undertaking or scheme. That amount of expenditure cannot be regarded as significant for s CB 13 purposes when considered relative to the value of the land, and the absolute amount of the relevant expenditure being only \$10,000 is not sufficiently substantial to indicate that s CB 13 should apply to the sales of those lots irrespective of the relativities. The amounts derived on the sales of those three lots are therefore not income under s CB 13.
64. By the time the remaining 15 lots were sold, all of the \$200,000 of relevant expenditure on the undertaking or scheme had been incurred. Prior to the commencement of the undertaking or scheme, the land was valued at \$1.4m, and it sold for a total of \$2.3m. The expenditure was therefore approximately 14.3% of the pre-development value of the land and approximately 8.7% of the post-development value of the land. The relevant expenditure as a percentage of the pre and post development value of the land is significant for s CB 13 purposes. Further, the absolute amount of the relevant expenditure of \$200,000 is not sufficiently small to indicate that s CB 13 should not apply to the sales of the last 15 lots irrespective of the relativities. The amounts derived on the sales of those 15 lots are therefore income under s CB 13. The G Family Trust is able to claim a deduction under s DB 27 for the value of that portion of the land at the time the undertaking or scheme commenced.

### **Example 2 – Significant expenditure and the context of the project**

65. Yasmin and Alex owned a house on a 2000m<sup>2</sup> semi-rural section. Yasmin and Alex decide to build a flat on the front part of the section before selling it. The property is on a hill, so the project included excavation, levelling, and construction of a retaining wall. In addition, water and sewage pipes to the new dwelling were laid, and a driveway paved. The development work, including relevant council consents, the drawing up of the plans for the preparation of the site, and all of the physical work, cost a total of approximately \$60,000. The property was valued at \$550,000 prior to the work, and sold for \$1,000,000.
66. As noted, the total cost of the development work was \$60,000. The cost of construction of the new dwelling is not relevant, as that work is not **“development” work for the purposes of s CB 13**, as it is not work in preparing the land for an intended use.

67. The relevant expenditure was therefore approximately 10.9% of the pre-development value of the land, and approximately 6% of the post-development value of the land. When considered relative to the pre-development value of the land, the expenditure appears to be significant. The absolute amount of the relevant expenditure being \$60,000 is not by itself sufficiently small to indicate that s CB 13 should not apply to the sale of the land irrespective of the relativities. However, when the expenditure is considered in the context of it being for a relatively modest project on a single residential block, it is not regarded as significant for s CB 13 purposes. The amount derived on the sale of the property is therefore not income under s CB 13.

### **Example 3 – Significant expenditure and absolute amounts**

68. Kaching Ltd owns a piece of industrial-zoned land in Auckland. Kaching Ltd decides it is timely to develop and sell the land. Kaching Ltd decides to develop a shopping complex on the land, which, prior to the development, was valued at approximately \$30m.
69. Kaching Ltd applied to have the land re-zoned for high-density commercial use, undertook master planning for the development, and commissioned a geotechnical report, an infrastructure report, an architectural plan and an archaeological assessment. Kaching Ltd engaged contractors to level the land, lay the water and sewerage pipes and install driveways, a carpark and associated kerbing. The shopping complex was then constructed, and Kaching Ltd is in negotiations with interested purchasers. Expenditure on the works, excluding the construction of the complex, totalled \$1.25m.
70. All of the \$1.25m expenditure is relevant for s CB 13 purposes, as it is all developmental in nature.
71. The expenditure was therefore approximately 4.2% of the pre-development value of the land. When considered relative to the pre-development value of the land, the expenditure does not appear overly significant. However, the absolute amount of the expenditure (\$1.25m) is sufficiently substantial for the expenditure to be regarded as significant for s CB 13 purposes, despite the amount relative to the value of the land not seeming overly significant on its own. This conclusion is further bolstered when the expenditure is considered in the context of it being incurred as part of a major commercial development. The amount derived on the sale of the property will therefore be income under s CB 13. Kaching Ltd will be able to claim a deduction under s DB 27 for the value of the land at the time the undertaking or scheme commenced.

## References

### Related rulings/statements

IG0010 "Work of a minor nature" *Tax Information Bulletin* Vol 17, No 1 (February 2005): 5

### Subject references

Income Tax, undertakings or schemes involving development of land or division of land into lots, significant expenditure, major projects involving development of land

### Legislative references

Income Tax Act 2007, ss CB 13, DB 27, ZA 3, and Schedule 51

Income Tax Act 2004, s YA 3 and Schedule 22A

Income Tax Act 1994, s CD 1(2)(g)

### Case references

*Aubrey v CIR* (1984) 6 NZTC 61,765 (HC)

*Dobson v CIR* (1987) 9 NZTC 6,025 (HC)

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### Other references

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