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TAX INFORMATION Bulletin

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

You can find a list of the items we are currently inviting submissions on as well as a list of expired items at **www.ird.govt.nz/public-consultation**

Email your submissions to us at **public.consultation@ird.govt.nz** or post them to:

Public Consultation
Office of the Chief Tax Counsel
Inland Revenue
PO Box 2198
Wellington 6140

You can also subscribe at **www.ird.govt.nz/public-consultation** to receive regular email updates when we publish new draft items for comment.

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This is a decision of the Taxation Review Authority ("TRA") finding that, for the purposes of s CB 6 of the Income Tax 2007, a land is acquired earlier than the date of registration. In this case the TRA found that the land at issue was acquired on the date of settlement and the disputant did not have an intention to dispose of the land on that date.

Taxation Review Authority finds no taxable activity and upholds the Commissioner's GST reassessments and deregistration 18

This is a decision of the Taxation Review Authority upholding the Commissioner of Inland Revenue's reassessments of the disputants' Goods and Services Tax ("GST") returns. The input tax credit claimed by the disputants was disallowed and the disputants' GST registration was cancelled from the dates that the disputants originally registered on the basis that the disputants did not have a taxable activity.

Application of time bar provisions - s 108 and 108B of the Tax Administration Act 1994 20

This is a decision of the Taxation Review Authority on a preliminary time bar issue dismissing the disputant's claim in relation to the application of time bar provisions to the assessments in respect of the disputant's 2001-2005 tax years.

High Court held that the Commissioner's opinion in section 108(2) of the Tax Administration Act 1994 must be determined by the hearing Authority on a de novo basis 21

This is an appeal to the High Court against the Taxation Review Authority's ("TRA") finding that the Commissioner of Inland Revenue ("the Commissioner") was correct to hold the opinion that the appellants' tax returns were fraudulent or wilfully misleading pursuant to s 108(2) of the Tax Administration Act 1994. The Commissioner cross-appealed the TRA's finding that the appellants had not committed evasion.

The High Court held that the TRA was wrong to restrict her reconsideration of the Commissioner's time bar ruling to whether the Commissioner's opinion was honestly held and reasonably available on the evidence. Williams J concluded that the TRA ought to have reviewed the ruling de novo.

Williams J dismissed the Commissioner's cross-appeal because Williams J considered that the TRA was right to come to the conclusion that the Commissioner had not proved Mr Edwards was dishonest as that conclusion was very much open to her on the evidence.

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Impact of bankruptcy on ability to bring challenge proceedings 24

The High Court dismissed an appeal from a Taxation Review Authority ("TRA") decision, upholding the TRA's decision to dismiss a challenge proceeding on the basis that:

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Crediting may not constitute payment 27

The High Court held that crediting an amount to a shareholder's current account in respect of an existing liability in circumstances where there were insufficient funds for the shareholder to draw down the full amount, did not constitute payment. Because there was no final payment under the financial arrangement in this case, a base price adjustment was not required.

NEW LEGISLATION

This section of the *TIB* covers new legislation, changes to legislation including general and remedial amendments, and Orders in Council.

Order in Council

FIF deemed rate of return set for 2015–16

The deemed rate of return for taxing foreign investment fund (FIF) interests is 6.77% for the 2015-16 income year, down from 7.71% for the previous income year.

The deemed rate of return is set annually and is one of the methods that can be used to calculate income from foreign investment fund interests. The rate is based on taking an average of the five-year Government bond rate at the end of each quarter, plus a 4% margin.

The new rate was set by Order in Council on 22 August 2016.

Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2015–16 Income Year) Order 2016 (LI 2016/190).

QUESTIONS WE'VE BEEN ASKED

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

QB 16/07: Income tax - land sale rules -main home and residential exclusions - regular pattern of acquiring and disposing, or building and disposing

This Question We've Been Asked (QWBA) provides guidance about when someone selling land will have a "regular pattern" of transactions that means they cannot use the residential exclusion from ss CB 6 to CB 11, and when someone selling land will have a "regular pattern" of transactions that means they cannot use the main home exclusion from the 2-year bright-line test.

Before the issue of whether there is a "regular pattern" arises, one of the taxing provisions in ss CB 6A to CB 11 has to potentially apply, and the residential exclusion or the main home exclusion has to potentially apply (see the flowchart at [10]). This QWBA briefly sets out the criteria for those taxing provisions and exclusions, but the focus is on when there will be a "regular pattern" of transactions that means the relevant exclusion cannot be used.

In this QWBA, we use the term "house" for ease of reference. The term in the residential exclusion from ss CB 6 to CB 11 is "dwellinghouse", and the term in the exclusion from the 2-year bright-line test is a "dwelling". Those terms could include other dwellings that are not houses (eg, a unit or an apartment).

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

This QWBA is about ss CB 16 and CB 16A.

Question

1. One of the land sale rules in ss CB 6 to CB 11 or the 2-year bright-line test in s CB 6A potentially applies to the sale of my house. I might qualify for exclusions from those rules for my residence or for my main home, but those exclusions may not apply if I have a "regular pattern" of transactions. When will I have a "regular pattern" of transactions that means I cannot use the exclusions for my residence or for my main home?

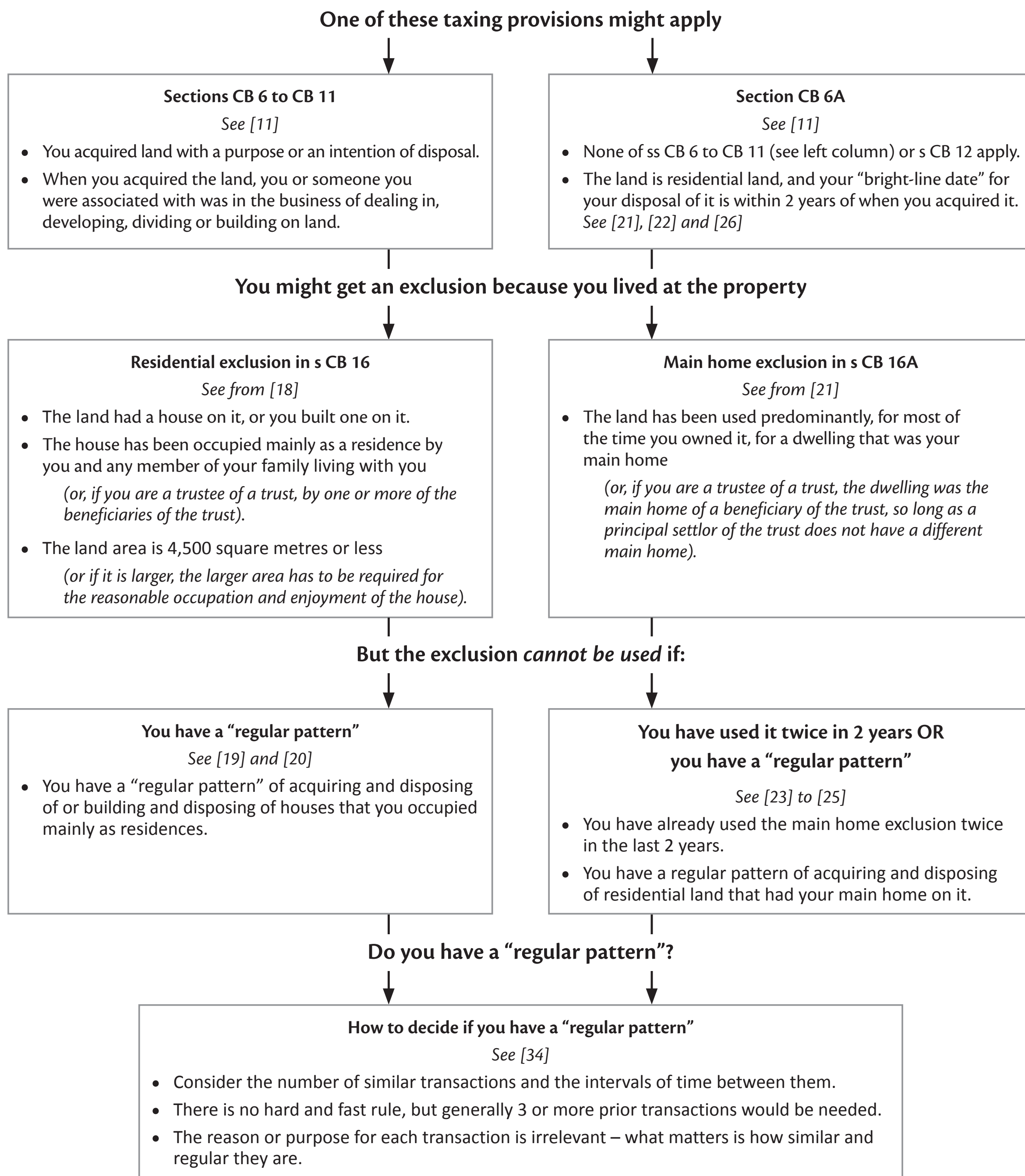
Answer

2. There are a number of land sale rules in the Act that might tax you on the proceeds of land that you sell or otherwise dispose of. But the provisions that might apply if you are selling your house have exclusions you might be able to use, which would mean you are not taxed. There are different exclusions depending on which provision you could be taxed under.
3. There is an exclusion (in s CB 16) called the "residential exclusion" which is relevant if you might be taxed under ss CB 6 to CB 11. If that exclusion applies, you will not be taxed under those provisions. But you will not be able to use that exclusion if you have a "regular pattern" of acquiring and disposing of or building and disposing of houses that you occupied mainly as residences.
4. There is an exclusion (in s CB 16A) called the "main home exclusion" which is relevant if you might be taxed under the 2-year bright-line test in s CB 6A. If that exclusion applies, you will not be taxed under the bright-line test. But you will not be able to use that exclusion if you have already used the main home exclusion twice in the last two years **or** if you have a "regular pattern" of acquiring and disposing of residential land that had your main home on it.
5. Whether you have a "regular pattern" of transactions that will mean you cannot use the relevant exclusion will depend on *the number of similar transactions and the intervals of time between them*. It will be a matter of fact and degree whether you have a regular pattern of such transactions.
6. There is no hard and fast rule about the number of times or how frequently you can buy and sell, build and sell, or renovate and sell houses that you live in and not be taxed. However, generally at least three prior transactions would be needed for there to be a regular pattern.

7. For there to be a "pattern" there has to be a *similarity or likeness between the transactions.* The reason or purpose for each transaction is irrelevant; it is the similarity of the transactions that is important. For a pattern to be "regular" *the transactions must occur at sufficiently uniform or consistent intervals*.
8. The transaction being considered as potentially subject to tax is **not** taken into account in deciding whether you have a regular pattern of such transactions.
9. As mentioned at [4], there is also a cap on how frequently you can use the main home exclusion from the 2-year bright-line test. You are not able to use that exclusion if you have already used it twice in the two years before the "bright-line" date for land you are selling. This cap applies *even if you do not have a "regular pattern"* of acquiring and disposing of residential land.

Flowchart – the taxing provisions and exclusions that may be relevant if you sell your house

10. The following flowchart shows the main taxing provisions that could apply if you sell your house, the requirements for the residential exclusion and for the main home exclusion that you might be able to use because it was your house, and when you cannot use those exclusions.
For a list of all the land sale provisions that might apply see [11].



Explanation

What taxing provisions might apply to me?

11. There are a number of land sale rules in the Act. These rules might tax you on the proceeds of land you sell or otherwise dispose of. You might be taxed on the proceeds of disposing of land if:
    - you acquired the land for a purpose or with an intention of disposing of it (s CB 6);
    - you acquired the land for the purpose of a business (carried on by you or by an associated person) of dealing in land, developing land, dividing land into lots, or erecting buildings (s CB 7);
    - you dispose of the land within 10 years of acquiring it, if at the time you acquired it you were (or were associated with someone who was) in the business of dealing in land, or developing or dividing land (ss CB 9 and CB 10);
    - you dispose of the land within 10 years of completing improvements to it, if at the time the improvements were started you were (or were associated with someone who was) in the business of erecting buildings (s CB 11);
    - the land was part of an undertaking or scheme, meeting certain criteria, that involved the development of land or the division of land into lots (ss CB 12 and CB 13);
    - the land was used as landfill (s CB 8);
    - you dispose of the land within 10 years of acquiring it and 20% or more of the increase in its value arises from any of various factors such as a change to the rules of a district plan, the granting of a consent, or a decision of the Environment Court under the Resource Management Act 1991 (s CB 14);[1]
    - you received the land from someone you were associated with, who would have been taxable if they had retained and disposed of the land (s CB 15); or
    - none of sections CB 6 to CB 12 apply, the land is residential land, and the "bright-line date" for your disposal of the land is within two years of when you acquired it (s CB 6A).[2]

But I am not taxed if I lived in the property, am I?

12. There are a number of exclusions from each of the above rules that might be relevant to you. If one of those exclusions applies, you will not be taxed on the sale proceeds.
13. There are exclusions from most of the land provisions for your residence, and there is an exclusion from the 2-year bright-line test for your main home.
14. Section CB 16 is the residential exclusion from ss CB 6 to CB 11, s CB 17 is the residential exclusion from ss CB 12 and CB 13, and s CB 18 is the residential exclusion from s CB 14. Section CB 16A is the main home exclusion from the 2-year bright-line test. Each of those exclusions has different requirements.
15. This QWBA is about one of the criteria of the residential exclusion from ss CB 6 to CB 11 (which is in s CB 16) and the main home exclusion from the 2-year bright-line test (which is in s CB 16A). Both of those exclusions have a requirement that you do not have a regular pattern of transactions. If you do have a regular pattern of the relevant transactions, you cannot use the residential exclusion or the main home exclusion (as the case may be), *even though you lived at the property*.
16. Note that the residential exclusions in ss CB 17 (relevant for ss CB 12 and CB 13) and CB 18 (relevant for s CB 14) do not have a requirement that there is no "regular pattern".
17. This QWBA explains when a "regular pattern" of transactions will prevent you from being able to use the residential exclusion in s CB 16, and when a "regular pattern" of transactions will prevent you from being able to use the main home exclusion in s CB 16A.

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

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

What are the requirements for the residential exclusion from ss CB 6 to CB 11?

18. The residential exclusion in s CB 16 is the relevant exclusion if the proceeds from the sale of your house might be taxed under any of ss CB 6 to CB 11 (those provisions include the purpose or intention provision, and the dealer, developer, subdivider and builder provisions).[3]

19. To qualify for the exclusion in s CB 16, you have to meet **all** of the following requirements:
    - You acquired the land with a house on it, or built one on it.
    - The house has been occupied mainly as a residence by you and any member of your family living with you or, if you are a trustee of a trust, by one or more of the beneficiaries of the trust.
    - This means your occupation of the house cannot be incidental to another more significant purpose such as sale (see, for example, *Case* G76 (1985) 7 NZTC 1,348, *Case* K21 (1988) 10 NZTC 218 and *Case* M102 (1990) 12 NZTC 2,634).
    - If there is any land related to the land with the house on it, the total area of the related land has to be 4,500 square metres or less. If it is larger than that, the larger area has to be required for the reasonable occupation and enjoyment of the house.
    - You have not engaged in a regular pattern of acquiring and disposing of houses, or building and disposing of houses, that you occupied mainly as residences (discussed from [32]).

20. As can be seen, one of the requirements of the residential exclusion in s CB 16 is that you do not have a "regular pattern" involving the disposal of land with a house on it. The "regular pattern" has to be either of acquiring and disposing of **houses that you occupied mainly as residences**, or of building and disposing of **houses that you occupied mainly as residences**. It does not matter if you have any other regular pattern involving acquiring and disposing of land, such as industrial land, or residential land that you did not live on.

What are the requirements for the main home exclusion from the 2-year bright-line test?

21. If you acquire residential land and sell it (or otherwise dispose of it) within two years of when you are treated as acquiring it, any gains may be taxed under the 2-year bright-line test (s CB 6A). This test can only apply if none of ss CB 6 to CB 12 apply.

22. There are special rules about when you are treated as acquiring the land for the 2-year bright-line test, which differ from when you are treated as acquiring the land for the other land sale rules. In a typical land purchase situation, the 2-year period for the bright-line test will start when the land title is registered to you.

23. Your *main home* may be excluded from the 2-year bright-line test. To qualify for that exclusion (which is in s CB 16A) you have to meet **all** of the following requirements:
    - The land has been used predominantly, for most of the time you owned it, for a dwelling that was your main home.[4]
    - You have not already used the main home exclusion twice within the two years immediately before the "bright-line date"[5] for the land in question.
    - You have not engaged in a regular pattern of acquiring and disposing of residential land that had your main home on it (discussed from [32]).

24. If you have a "regular pattern" of acquiring and disposing of residential land that had your main home on it, you will still be taxed on the proceeds of the sale of the land even if you have not already used the main home exclusion twice in the two years before the "bright-line date".

25. The "regular pattern" has to be of acquiring and disposing of **residential land that had your main home on it** (see further from [28]). It does not matter if you have a regular pattern of acquiring and disposing of other land, such as farmland, land that a dwelling cannot be built on under the relevant district plan (eg, industrial land), or residential land that you did not live on.

[3] Which also apply if you are associated with a dealer, developer, subdivider or builder, even if you are not one yourself.

[4] Note, if you are a trustee of a trust, the exclusion can apply if the dwelling was the main home of a beneficiary of the trust. This is as long as a principal settlor of the trust does not have a main home or, if they do, it is the property you are disposing of.

[5] In a typical land sale situation, this will be the date that you enter into an agreement for the disposal of the land. But your "bright-line date" could be a different date, depending on how you dispose of the land (see s CB 6A(7)).

26. The 2-year bright-line test can only potentially apply to a disposal of land if you first acquired an estate or interest in the land on or after 1 October 2015. However, if the first interest in the land was acquired on or after 1 October 2015, you must take into account acquisitions and disposals before that date in deciding whether you have a "regular pattern" of acquiring and disposing of residential land that had your main home on it.

Requirement that the regular pattern relates to land that you occupied mainly as a residence, or that had your main home on it

27. As noted above, for a "regular pattern" to prevent the relevant exclusion from applying, it has to be a regular pattern of acquiring and disposing of land that you occupied **mainly as a residence** (in the case of the land sale rules that the exclusion in s CB 16 is relevant to), or that had your **main home** on it (in the case of the 2-year bright-line test).

28. While the legislation does not expressly state that the regular pattern has to be of acquiring and disposing of land that you occupied mainly as a residence, or that had your main home on it, the Commissioner considers this is the correct interpretation.

29. In terms of the s CB 16 exclusion, the Commissioner considers this interpretation to be correct because of the way the legislation was worded before the Act was re-written for simplicity. There was no intention to narrow the scope of the exclusion when the Act was re-written. It is also supported by the fact that if the pattern did not need to relate to land that you occupied mainly as a residence, people who are in the business of dealing in land would likely not be able to use the exclusion in s CB 16. However, it was clearly intended that they could, because s CB 16 is an exclusion from all of ss CB 6 to CB 11, including the dealer, builder and developer provisions.

30. Similarly, the Commissioner considers that the regular pattern has to be of acquiring and disposing of land that had your main home on it for you to be prevented from using the main home exclusion from the 2-year bright-line test. This is because the wording of the main home exclusion was based on the wording of the residential exclusion in s CB 16, and because of what the context of the land provisions as a whole and the ordering of the different land sale rules suggest about how the provisions are intended to operate. It is also supported by comments in the special report *Bright-line Test for Residential Land* (Inland Revenue, Wellington, 2015).

So what is a "regular pattern" of acquiring and disposing or building and disposing?

31. The High Court and the Taxation Review Authority have considered a number of cases that required looking at whether there was a "regular pattern" of acquiring and disposing of houses or building and disposing of houses, which would mean the residential exclusion in s CB 16 could not be used. The same principles are relevant when considering whether there has been a "regular pattern" of acquiring and disposing of residential land for the purposes of the main home exclusion from the 2-year bright-line test.

32. In *Parry v CIR* (1984) 6 NZTC 61,820 (HC), the High Court made the following comments about the meaning of "regular pattern" in what is now s CB 16 (at 61,824):

> I commence with the phrase "a regular pattern of such transactions". In my view, in the context in which it is used, "pattern" denotes a similarity or likeness in the transactions. The transactions relied on must bear a similarity or likeness each to the others.
>
> In the same context the word "regular" is used in the sense of recurring at uniform or near uniform intervals. There must therefore be a sufficient degree of uniformity or at least consistency of occurrence.
>
> So in considering whether there has been a regular pattern of erecting dwellinghouses and subsequent sale, the Court must consider each transaction to assess the degree of similarity each to the others. This involves considering factors such as the type and location of the sections, the type of the dwellinghouses, the method of erection, the use to which the dwellinghouses were put and, in particular, whether occupied by the objector, and any other characteristics of the transaction that may be relevant in assessing similarity. The Court must also consider the number of transactions and the intervals of time between each, thereby assessing the degree of uniformity or consistency of occurrence. In the end it will have to determine as a matter of fact and degree whether the events that occurred demonstrate a regular pattern of such transactions.
>
> On this approach it does not seem to me to be relevant to consider the reason or purpose for each transaction. It is the similarity of the transactions that is significant, not any similarity in the reason, purpose or intention for entering into each transaction.

33. The court also noted that the regular pattern has to exist independently of and before the transaction in question.

34. In deciding whether there is a "regular pattern" for the purposes of the residential exclusion in s CB 16, the key things to bear in mind are:
   - For there to be a "pattern", there has to be a similarity or likeness between the transactions.
   - The reason or purpose for each transaction is irrelevant; it is the similarity of the transactions that is important.
   - Assessing the similarity between the transactions involves considering factors such as the type and location of each of the sections of land, the type of dwellinghouses, the method of erection, the use to which the dwellinghouses were put (in particular whether you occupied them),[6] and any other relevant characteristics of the transactions.
   - For a pattern to be established, there must be more than one transaction. The greater the number of similar transactions, the more likely there is a pattern.
   - For a pattern to be "regular", the transactions must occur at sufficiently uniform or consistent intervals.
   - The number of similar transactions and the intervals of time between them must be assessed, and it is a matter of fact and degree whether there is a regular pattern of such transactions.
   - There must be at least two similar transactions for there to potentially be a regular pattern (*Case C9* (1977) 3 NZTC 60,058). But the Commissioner accepts that generally at least three prior transactions would be needed for there to be a regular pattern.
   - You must have engaged in a regular pattern of the relevant type of transactions independently of and before the transaction in question. The transaction being considered as potentially subject to tax is not taken into account in deciding whether there is a regular pattern of transactions.
   - (See also *Case 5/2013* [2013] NZTRA 05 (2013) 26 NZTC 2,004, *Case M102* and *Case C9*.)

35. As noted above, the type of "regular pattern" that will mean you cannot use the exclusion for your house is:

   in the case of any of the land sale rules in ss CB 6 to CB 11:

   – a "regular pattern" of acquiring and disposing of houses that you occupied mainly as residences; or

   – a "regular pattern" of building and disposing of houses that you occupied mainly as residences; and

   in the case of the 2-year bright-line test (s CB 6A):

   – a "regular pattern" of acquiring and disposing of residential land that had your main home on it.

36. If you have any other pattern involving acquiring or disposing of land, it will not prevent you from relying on the exclusion for your house. For example, if you have a pattern of speculative buying and selling of land you have not lived on, or if, as part of your business, you buy and sell land you have not lived on.

Is it true that I can renovate and sell a house every year or two and not be taxed, as long as I lived in the house?

37. A common misconception is that you can renovate and sell a house every year or two and not be taxed on the sale proceeds, as long as you lived in the house. This is not true. Whether you are taxed on the sale proceeds of a house you have lived in depends on whether there is a taxing provision you might be caught by (these are listed at [11]), and then whether you meet the requirements for an exclusion from that provision.

38. As noted above, the exclusions for a person's house **cannot be used** if you have:
   - a "regular pattern" of acquiring and disposing or building and disposing of houses that you occupied mainly as residences (in the case of the provisions in ss CB 6 to CB 11 – which include the purpose or intention provision, and the dealer, developer, subdivider and builder provisions); or
   - a "regular pattern" of acquiring and disposing of residential land that had your main home on it (in the case of the 2-year bright-line test (s CB 6A)).

39. If you renovated and sold your house every year, you would establish a regular pattern that would prevent you from being able to use the residential exclusion from ss CB 6 to CB 11 or the main home exclusion from the 2-year bright-line test.

[6] As discussed from [28], the regular pattern has to be of acquiring and disposing of land that you occupied mainly as a residence, or that had your main home on it. As such, whether, and the extent to which, you occupied any particular property is important in terms of the relevance of that transaction to deciding whether you have a regular pattern.

40. Note that even if you do not have a regular pattern of acquiring and disposing of residential land that had your main home on it, you would not be able to use the main home exclusion from the 2-year bright-line test if you had already used it twice in the two years before the "bright-line date" for land you are selling.

41. If you renovated and sold houses that you lived in less frequently, for example every two or more years, you would at some stage establish a regular pattern. If one of the land sale rules in ss CB 6 to CB 11 was potentially applicable (for example, if you purchased the land with a purpose or an intention of disposing of it, or if you or someone you are associated with is a land dealer, developer, subdivider or builder), your regular pattern may mean that you cannot use the residential exclusion and might be taxed on the sale of a house you lived in.

42. You could also potentially be taxed under one of the undertaking or scheme provisions (s CB 12 in particular) if your renovations involved more than minor development or division work. As noted above, the undertaking or scheme provisions have their own separate residential exclusion, which does not have a requirement that there is no "regular pattern" involving the disposal of land. But there are a number of requirements that must be met for you to be able to use that exclusion, so you would need to consider whether those requirements were met.

43. Even if you sell a property that you live in without renovating it, one of the land sale rules could apply to you, so you may need to consider whether you have a regular pattern involving disposal of property that you lived in.

44. There is no hard and fast rule about the number of times or how frequently you can buy and sell, build and sell, or renovate and sell houses and not be taxed.

What if I have to sell a number of houses because of circumstances outside my control?

45. The reason or purpose for buying and selling or building and selling is irrelevant in deciding whether you have a "regular pattern" of transactions – even if the reason or purpose for the sale is outside your control. What matters is whether you have engaged in a regular pattern of transactions of the relevant type.

46. If you sold one or two houses that you lived in, you would not be taxed on the sale proceeds (as long as you meet the other criteria for the residential exclusion or the main home exclusion), as you would not have a "regular pattern" involving disposal at that point. If you sold more than that, for whatever reason, there may be a question of whether you have a regular pattern. As noted above, this would involve considering the number of similar transactions and the intervals of time between them. Generally, at least three prior transactions would be needed for there to be a regular pattern.

If I cannot use the residential exclusion or the main home exclusion and have to pay tax on a land sale, can I get any tax deductions?

47. Yes. If one of the land sale rules applies to tax you on the proceeds of selling land, you will get a deduction for the cost of the land and any capital improvements you make to it, to the extent that those costs are incurred in deriving the income and are not private in nature (ss DB 23, DA 1 and DA 2(2)). The deduction is taken in the income year in which you dispose of the land (see s EA 2).

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

Examples

49. The following examples are included to assist in explaining the application of the law. The focus of the examples is on the "regular pattern" aspect of both the residential exclusion from ss CB 6 to CB 11 and the main home exclusion from s CB 6A. The examples are therefore premised on the other criteria for the relevant exclusion being satisfied. The examples are also premised on the relevant taxing provision being applicable, subject to the potential availability of the residential exclusion or the main home exclusion.

Example 1 – A "regular pattern" of transactions established

50. Melody and David are keen house renovators and have purchased a number of properties to improve and sell at a profit. These purchases and sales are shown in the following table.

Property	Date acquired	Land / activity	Date sold
1 (N Road)	June 2006	Cottage in inner-city Wellington suburb purchased. Renovations undertaken over the period of ownership, while Melody and David lived in the house.	May 2008
2 (P Street)	May 2008	Bungalow in Wellington suburb purchased. Renovations and landscaping undertaken over the period of ownership, while Melody and David lived in the house.	July 2010
3 (E Place)	July 2010	House in Wellington suburb purchased. Off-street parking built during the period of ownership, while Melody and David lived in the house.	February 2011
4 (J Avenue)	January 2011	Larger family home in Wellington suburb purchased, as Melody and David had started a family. Some minor redecorating undertaken during the period of ownership, while Melody and David lived in the house.	March 2013

51. Melody and David purchased the properties for a purpose and with an intention of selling them after they had completed some improvements. Their aim was to renovate the properties while they lived in them and sell them at a profit, enabling them to move up the property ladder. As such, the proceeds from the sales may be subject to tax under s CB 6 – the purpose or intention provision. This depends on whether Melody and David can rely on the residential exclusion in s CB 16.

52. Melody and David acquired the properties with houses on them, and it is assumed that they occupied the houses mainly as their residences. It is also assumed that the area of each property was 4,500 square metres or less. Therefore, the only issue is whether Melody and David are precluded from using the residential exclusion, which they will be if they have engaged in a *regular pattern of acquiring and disposing of houses that they occupied mainly as residences.*

53. When the first three properties (N Road, P Street and E Place) were sold, Melody and David did not yet have a regular pattern of acquiring and disposing of houses. A regular pattern has to exist independently of the transaction being considered. By the time E Place was sold, there had only been two prior acquisitions and sales. The Commissioner accepts that generally at least three transactions would be needed for there to be a regular pattern.

54. By the time the J Avenue property was sold, Melody and David had previously acquired and disposed of three houses that they had lived in. The question is whether those three transactions amount to a regular pattern of acquiring and disposing of houses that were occupied by the couple mainly as residences. If they do amount to such a regular pattern, Melody and David will not be able to rely on the residential exclusion for the sale of the J Avenue property.

55. For there to be a pattern, there has to be a similarity or likeness between the transactions. In this case, there is. The N Road, P Street and E Place properties were all residential properties in Wellington acquired, occupied, renovated and sold by Melody and David. It does not matter that the nature of the renovations done to each property was different. The pattern only needs to involve acquiring and disposing of houses that have been occupied mainly as residences.

56. For a pattern of acquisition and disposal to be regular, the transactions need to occur at sufficiently uniform or consistent intervals. In this case, the properties were held for 1 year 11 months, 2 years 2 months, and 7 months, respectively. Three properties were acquired and disposed of in a period of 4 years 8 months. The Commissioner considers that the intervals between the transactions are consistent enough for this to be a regular pattern. The intervals between the transactions do not need to be identical.

57. Because Melody and David have engaged in a regular pattern of acquiring and disposing of houses that they occupied mainly as residences, they cannot use the residential exclusion in s CB 16. Therefore, the proceeds from the sale of the J Avenue property will be income to Melody and David under s CB 6. Melody and David can deduct the costs of the property and the redecorating, to the extent that those costs are not private in nature.

58. The 2-year bright-line test does not apply to the sales of the N Road, P Street or E Place properties, because they were all acquired before 1 October 2015 (and in the case of the P Street property, the land was held for over two years, in any event).

Example 2 – A "pattern" of transactions, but not a "regular pattern"

59. Enzo, who is in the business of dealing in land, has purchased and sold dozens of residential properties over the last decade as part of his business. In that time, he has also sold four properties that he lived in, as shown in the following table.

Property	Date acquired	Land / activity	Date sold
1 (Q Street)	February 2006	Apartment in Auckland CBD purchased. Lived in by Enzo, and then subsequently by his partner too.	June 2007
2 (M Place)	July 2007	House on the North Shore purchased, as Enzo and his partner decided to adopt a child. Lived in by the family for the period of ownership.	December 2012
3 (G Road)	December 2012	Larger house in Auckland purchased to accommodate the expanding family. Lived in by the family for the period of ownership.	October 2015
4 (T Road)	October 2015	House on a small lifestyle property outside of Hamilton purchased. Lived in by the family until early January 2016, when Enzo's partner accepted an exciting job offer in Sydney and the family decided to move there. The sale of the house was settled at the end of January 2016.	January 2016

60. Because Enzo is in the business of dealing in land and all of the above properties were sold within 10 years of being acquired, Enzo (and his partner, where relevant) may be taxed on the proceeds of the sales under s CB 9. However, this depends on whether Enzo and his partner can rely on the residential exclusion in s CB 16.

61. Enzo (and his partner, where relevant) acquired the properties with houses on them, and it is assumed that they occupied the houses mainly as their residences. It is also assumed that the area of each property was 4,500 square metres or less. Therefore, the only issue is whether Enzo and his partner are precluded from using the residential exclusion, which they will be if they have engaged in *a regular pattern of acquiring and disposing of houses that they occupied mainly as residences.*

62. The numerous residential properties Enzo has purchased and sold as part of his business are not relevant to deciding whether there is a regular pattern of the type that would prevent Enzo and his partner from relying on the residential exclusion.

63. When the first three properties (Q Street, M Place and G Road) were sold, Enzo and his partner did not yet have a regular pattern of acquiring and disposing of houses that they occupied mainly as residences. A regular pattern has to exist independently of the transaction being considered. By the time the G Road property was sold, there had only been two prior acquisitions and sales. The Commissioner accepts that generally at least three transactions would be needed for there to be a regular pattern.

64. By the time the T Road property was sold, Enzo (and his partner, where relevant) had previously acquired and disposed of three houses that they lived in. The question is whether those three transactions amount to a regular pattern of acquiring and disposing of houses that were occupied by the couple mainly as residences. If they do amount to such a regular pattern, Enzo and his partner will not be able to rely on the residential exclusion for the sale of the T Road property.

65. For there to be a **pattern**, there has to be a similarity or likeness between the transactions. In this case, there is. The Q Street, M Place and G Road properties were all residential properties in Auckland acquired, occupied, and sold by Enzo and his partner.

66. For a pattern of acquisition and disposal to be **regular**, the transactions need to occur at sufficiently uniform or consistent intervals. In this case, the properties were held for 1 year 4 months, 5 years 5 months, and 2 years 10 months, respectively. Three properties were acquired and disposed of in a period of 9 years 8 months. The Commissioner considers that the intervals between the transactions are not consistent enough for this to be a regular pattern.

67. Because Enzo and his partner have not engaged in a **regular pattern** of acquiring and disposing of houses that they occupied mainly as residences, they can use the residential exclusion in s CB 16. As noted at [62], it is assumed that the other requirements for the exclusion are met. Enzo and his partner will, therefore, not be taxed under s CB 9 on the proceeds of the sale of the T Road property.

68. However, the T Road property was acquired on or after 1 October 2015, sold within two years, and is "residential land" for the purposes of the 2-year bright-line test. This is because it has a dwelling on it, and it is not used predominantly as business premises and is not farmland. (It is not "farmland" as defined in the Act because, due to its size, it is not capable of being worked as a farming or agricultural business.) As such, it is also necessary to consider whether the proceeds of the sale of the T Road property are taxed under the 2-year bright-line test. This comes down to whether Enzo and his partner can rely on the main home exclusion in s CB 16A.
69. Enzo and his partner used the house on the T Road property predominantly, for most of the time they owned it, as their main home. Therefore, the only issue is whether Enzo and his partner are precluded from using the main home exclusion, which they will be if they have either:
    - already used the main home exclusion twice within the two years immediately before the "bright-line date"[7] for the T Road property, or
    - engaged in *a regular pattern of acquiring and disposing of residential land that had their main home on it*.
70. Enzo and his partner have not used the main home exclusion at all before, so they will only be precluded from using the main home exclusion if they have engaged in a regular pattern of acquiring and disposing of land that was their main home.
71. As with the residential exclusion from the land dealer provision, the numerous properties Enzo has purchased and sold as part of his business are not relevant to deciding whether there is a regular pattern of the type that would prevent Enzo and his partner from relying on the main home exclusion from the 2-year bright-line test.
72. Therefore, the only transactions that are relevant are the purchases and sales of the Q Street, M Place and G Road properties. Although the 2-year bright-line test only potentially applies to disposals of land acquired on or after 1 October 2015, acquisitions and disposals of residential land before then are relevant in deciding whether there is a "regular pattern" that means the main home exclusion cannot be used.
73. As with the residential exclusion from the land dealer provision, the Commissioner considers that the acquisitions and sales of the Q Street, M Place and G Road properties do not make up a regular pattern.
74. Because Enzo and his partner have not used the main home exclusion before and have not engaged in a regular pattern of acquiring and disposing of residential land that had their main home on it, they can use the exclusion when they sell the T Road property. Therefore, Enzo and his partner will not be taxed on the proceeds of the sale of the T Road property under the 2-year bright-line test (s CB 6A).

[7] In this case, the date that Enzo and his partner entered into the contract to sell the T Road property.

Example 3 – Transactions not similar enough to be a "pattern"

75. Hemi and Kirrily have acquired and sold a number of properties since they married five years ago, as shown in the following table.

Property	Date acquired	Land / activity	Date sold
1 (C Road)	May 2011	Investment property purchased before Hemi and Kirrily went overseas on their "OE", so they could get a foot on the property ladder. Property rented out from when purchased until when sold.	November 2013
2 (A Street)	November 2013	House purchased upon Hemi and Kirrily's return to NZ and the sale of their investment property. Lived in for the period of ownership.	October 2015
3 (H Street)	September 2015	Inherited Kirrily's father's unit upon his death. Listed for sale soon after, and never lived in by the couple.	October 2015
4 (K Avenue)	November 2015	When Kirrily and Hemi inherited the H Street property, they decided to sell it and the A Street property and buy a larger house (the K Avenue property) and a holiday bach (the B Esplanade property). The K Avenue property was lived in by the couple for the period of ownership.	February 2016
5 (B Esplanade)	November 2015	Seaside bach purchased with the proceeds of the A Street and H Street properties. The couple stayed in the bach most weekends during the period of ownership. The bach (the B Esplanade property) and the K Avenue property were both sold when Kirrily was diagnosed with a life-threatening illness, and the couple decided to use their equity to fund experimental medical treatment in Germany.	February 2016

76. The C Road, A Street and H Street properties are not potentially subject to tax under any of the land provisions in the Act.

77. However, the K Avenue and B Esplanade properties were both acquired after 1 October 2015, sold within two years, and are both "residential land" for the purposes of the 2-year bright-line test. This is because those properties both have dwellings on them, are not used predominantly as business premises, and are not farmland. As such, it is necessary to consider whether the proceeds of the sales of the K Avenue and B Esplanade properties are taxed under the 2-year bright-line test. This comes down to whether Hemi and Kirrily can rely on the main home exclusion in s CB 16A.

78. Hemi and Kirrily used the K Avenue property predominantly, for most of the time they owned it, as their main home. Therefore, the only issue is whether Hemi and Kirrily are precluded from using the main home exclusion, which they will be if they have either:

- already used the main home exclusion twice within the two years immediately before the "bright-line date"[8] for the K Avenue property; or
- engaged in *a regular pattern of acquiring and disposing of residential land that had their main home on it.*

79. Hemi and Kirrily have not used the main home exclusion at all before, so they will only be precluded from using the main home exclusion for the sale of the K Avenue property if they have engaged in a regular pattern of acquiring and disposing of land that was their main home.

[8] In this case, the date that Hemi and Kirrily entered into the contract to sell the K Avenue property.

80. By the time the K Avenue property was sold, Hemi and Kirrily had previously acquired and disposed of three residential properties – the C Road, A Street and H Street properties. The question is whether those three transactions amount to a regular pattern of acquiring and disposing of houses that were occupied by the couple mainly as residences. In this case, they clearly do not. This is because, for there to be a pattern, there has to be a similarity or likeness between the transactions. That is not the case here. The C Road, A Street and H Street properties were all residential properties, but one (the C Road property) was an investment property, one (the H Street property) was inherited by the couple, and one (the A Street property) was their home. The acquisitions and sales of those properties are not sufficiently similar to amount to a "pattern".
81. Because Hemi and Kirrily have not used the main home exclusion before and have not engaged in a regular pattern of acquiring and disposing of residential land that had their main home on it, they could use the exclusion when they sold the K Avenue property. Therefore, Hemi and Kirrily were not taxed on the proceeds of the sale of the K Avenue property under the 2-year bright-line test (s CB 6A).
82. However, Hemi and Kirrily did not use the house on the B Esplanade property as their main home. Therefore, they could not use the main home exclusion when they sold that property, and the proceeds of the sale of the property were income to them under the 2-year bright-line test (s CB 6A). Hemi and Kirrily could deduct the cost of the B Esplanade property and any other expenditure that was incurred in deriving the income, to the extent that those costs were not private in nature.

References

Subject references
Income tax, sale of land, main home exclusion, residential exclusion, regular pattern involving disposal
Legislative references
Income Tax Act 2007 – ss CB 6A, CB 6, CB 7, CB 9, CB 10, CB 11, CB 12, CB 13, CB 16A, CB 16, CB 17, DA 1, DA 2(2), DB 6, DB 7, DB 23 and EA 2
Case references
Case 5/2013 [2013] NZTRA 05, 26 NZTC 2,004 *Case C9* (1977) 3 NZTC 60,058 *Case G76* (1985) 7 NZTC 1,348 *Case K21* (1988) 10 NZTC 218 *Case M102* (1990) 12 NZTC 2,634 *Parry v CIR* (1984) 6 NZTC 61,820 (HC)
Other references
Bright-line Test for Residential Land (Inland Revenue, Wellington, 2015)

QUESTIONS WE'VE BEEN ASKED

LEGAL DECISIONS – CASE NOTES

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

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

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

Section CB 6 – date of acquisition of land and intention

Case	TRA 003/15 [2016] NZTRA 07
Decision date	28 July 2016
Act(s)	Income Tax Act 2007
Keywords	S CB 6, Income Tax Act 2007, date of acquisition, intention, disposal, land

Summary

This is a decision of the Taxation Review Authority ("TRA") finding that, for the purposes of s CB 6 of the Income Tax 2007 ("Act"), a land is acquired earlier than the date of registration. In this case the TRA found that the land at issue was acquired on the date of settlement and the disputant did not have an intention to dispose of the land on that date.

Impact

The TRA decision means that in terms of purchases of land before the introduction of s CB 15B of the Act (before 22 November 2013), the date of acquisition occurs earlier than the date of registration and determination of the acquisition date will depend on the facts of the case.

Facts

The disputant, who built up a successful business engaged in a property related activity, entered into a sale and purchase agreement in September 1996 for the purchase of a semi-rural property ("the Property") for $490,000.

The transaction was settled on 29 November 1996 and the transfer was registered on 14 March 1997.

In 1995 and 1996, there was publicity in the local newspapers relating to council proposals in the area. Under a draft plan released in 1996, the Property was identified for medium density residential development.

The disputant sold the Property in 2012 for $3,300,000.

Commissioner's position:

The Commissioner of Inland Revenue ("the Commissioner') contended that it is the registration of an instrument under the Land Transfer Act 1952 ("the LTA") that is the event which creates or transfers a legal interest in land. On this basis, an assumption that land is acquired when an equitable interest is acquired cannot be applied in the context of s CB6 of Act.

Disputant's position

The disputant's position was that the LTA was not authority for the date land is acquired for taxation purposes and that current case law showed an equitable interest in land can exist without the interest being registered on the title (the introduction of s CB15 has clarified the acquisition date of land for the purposes of s CB6, however, this provision only applies to purchases after 22 November 2013).

Decision

***Issue 1:** Acquisition of property for purposes of s CB 6 of the Act*

Judge Sinclair considered that for the purposes of s CB 6(1) of the Act, the date of acquisition is to be established at an earlier stage than the date of registration. She noted that depending on the facts, this date could arguably be when the taxpayer obtains an estate or interest under the particular agreement for sale and purchase (*Bevin v Smith* [1994] 3 NZLR 648 (CA)) or when the agreement becomes unconditional (*Beetham v Commissioner of Inland Revenue* [1973] 1 NZLR 575 (HC)).

Judge Sinclair also considered the definition of "land" and considered that the definition includes both equitable and legal interests and that the word "land" in s CB 6 of the Act encompasses the acquisition of either a legal or an equitable interest in land.

Based on the evidence, she concluded that the earliest date she could be satisfied of the disputant's involvement as purchaser of the Property was the date of settlement. Therefore, for the purposes of s CB 6(1) of the Act, the date of acquisition of the Property by the disputant was 29 November 1996.

Because of her factual findings (mentioned below), Judge Sinclair did not consider it necessary to determine the earliest date when acquisition could have occurred.

***Issue 2:** Purpose or intention of disposal for purposes of s CB 6 of the Act*

Judge Sinclair found the disputant to be a credible witness. Her Honour accepted the disputant's evidence that she had no expectation of a sale at the time the sale and purchase agreement was signed.

Judge Sinclair, having considered the totality of the circumstances, concluded that for the purposes of s CB 6 of the Act the disputant had the intention of making the Property her home at the date of the acquisition.

The Commissioner submitted that even if it was found that the disputant did intend to live in the Property, the disputant also had the intention to develop or dispose of the Property at some future time (when the zoning changed). The Commissioner referred to an Inland Revenue file note of August 1997 which stated that the disputant intended to develop the Property into 30 sections.

Judge Sinclair noted that there is no evidence of any plan for a subdivision or that such a development was contemplated. Her Honour, having found that the disputant decided not to move in to the Property before she made her Goods and Services Tax claim in May 1997, noted that the statements made in the file note relate to events after the disputant had decided not to live in the Property.

Under cross examination, the disputant stated that "ultimately years down the track" she would sell the Property. Judge Sinclair considered this to be simply a reflection of the disputant's general position with regard to property ownership.

In relation to the totality of the circumstances, Judge Sinclair made the following findings:

1. The nature, quality and location of the Property were consistent with the disputant's stated intention to purchase the Property as her home.
2. The disputant's prior activities and experience do not extend to direct knowledge and involvement in property development so that no inference can be drawn that this was her intention at the date of acquisition of the Property.
3. There was no evidence of any pattern of purchasing land to be held for development long term.
4. There was no contemporaneous evidence that at the time of the acquisition the disputant purchased the land deliberately to sit on it waiting a zoning change.
5. Despite the disputant's knowledge of the property market and its potential value, it could not be inferred that the disputant had the purpose or intention when she purchased the Property to hold it pending a zoning change and then dispose of it (either developed or undeveloped).

Judge Sinclair concluded the disputant had discharged the onus of proving she did not have the intention or purpose at the time of acquisition to subdivide and sell the property and therefore the amount received from the sale of the Property was not assessable income under s CB 6 of the Act.

Taxation Review Authority finds no taxable activity and upholds the Commissioner's GST reassessments and deregistration

Case	TRA 007/15 [2016] NZTRA 09
Decision date	9 August 2016
Act(s)	Goods and Services Tax Act 1985: ss 6 and 52; Tax Administration Act 1994
Keywords	Taxable activity

Summary

This is a decision of the Taxation Review Authority ("TRA") upholding the Commissioner of Inland Revenue's ("the Commissioner") reassessments of the disputants' Goods and Services Tax ("GST") returns. The input tax credit claimed by the disputants was disallowed and the disputants' GST registration was cancelled from the dates that the disputants originally registered on the basis that the disputants did not have a taxable activity.

Impact

This decision reaffirms that a taxable activity is necessary for a person to be registered for GST and entitled to claim input tax deductions. It also reaffirms the decision in *Case 7/2012* (2012) 25 NZTC 1-019 that commencement work is not sufficient and does not create, or amount to, a taxable activity.

Facts

The first disputant is an individual ("Mr S"). The second disputant is a company of which Mr S is the sole shareholder and director ("the Company"). The disputants filed GST returns claiming input tax deductions. The Commissioner took the position that the disputants were not engaged in any taxable activity in any of the relevant GST periods and reassessed the disputants' GST registration from the date of registration. The Commissioner also imposed shortfall penalties on each of the disputants for not taking reasonable care.

The disputants each challenge the Commissioner's reassessments and contend that they met the requirements to be registered for GST and are entitled to receive the GST refunds claimed. They also challenge the imposition of the shortfall penalties.

Mr S

On 27 January 2011 Mr S registered for GST with effect from 14 January 2011 for an activity described on the registration form as being "vineyard and farming". He stated on the form that his turnover in the previous 12 months was more than $60,000 and that he expected his turnover in the next 12 months would be greater than $60,000.

Mr S told the TRA that when he initially applied for registration he was proposing to develop two vineyards. The project was to be financed from various sources including overseas funders and from the repayment of a loan for $600,000.

Mr S claimed a GST refund of $1,267.17 for the period ended 31 August 2012. He wrote on the GST return "Purchasing grapes vineyard and winery". Mr S claimed a further refund of $17,795.80 in the period ended 30 September 2012. On the return for this period Mr S wrote "Start up of vineyard".

The Commissioner commenced an audit into Mr S's GST affairs in October 2012. In October 2012 Mr S advised that he had set up a company that would "handle most of my GST".

On 2 November 2012 Mr S requested his September 2012 GST return be amended to remove two tractors he had claimed costing $74,000 and $44,000 respectively. He advised that when the company was up and running he would purchase them through that entity.

In the period between June 2011 and January 2013 Mr S entered into around 40 agreements for the sale and purchase of wineries, vineyards and farms. The agreements were all conditional on finance being obtained. Either no deposit was payable or it was not payable until finance was arranged. None of these agreements settled.

In February 2013 The Commissioner wrote to Mr S advising that his GST registration would be cancelled with effect from the date of registrations and she disallowed all input claims made.

The Company

The Company was incorporated on 11 September 2012. On 11 October 2012, the Company registered for GST with effect from 1 October 2012. The business activity was described on the form as being "grow grapes/wine marketing". Mr S completed the form and stated that the Company's turnover in the previous 12 months was more than $60,000 and that its expected turnover in the next 12 months would exceed $60,000.

On 8 November 2012 Mr S provided the Commissioner with a copy of a business proposal for the Company. The proposal prepared by Mr S was for the purchase of established New Zealand vineyards. It was intended that the Company would be a parent company that would borrow the money and invest in various vineyards. These vineyards would be individually operated by separate entities to be wholly owned by the parent company. The proposal listed particular properties which it intended to purchase and sought a loan of $62 million.

On 20 November 2012 Mr S filed a GST return for the period ended 31 October 2012 on behalf of the Company. Purchases totalled $237,740.09 and an input tax deduction of $27,429.01 was claimed. The inputs included invoices for two motorbikes ($19,000) and a tractor ($186,875). The balance of inputs claimed related to private items and expenses previously claimed by Mr S in his individual GST return. Payment was never made on the farm machinery and the transactions were subsequently reversed.

Upon completion of the audit the Commissioner cancelled the GST registration of the Company with effect from the date of registration and disallowed all input tax deductions.

Decision

The TRA found that there was no evidence that either Mr S or the Company had the financial resources to commence the stated business activities.

The TRA noted that Mr S told the TRA during the hearing that finance was principally to be provided by offshore funders. He said that his project had run into a problem because of a substantial shift in the exchange rate between New Zealand and the United States which meant an extra $22 million was required to finance the project. However, upon the evidence before it, the TRA did not put any particular weight on that oral evidence.

The TRA found that Mr S did not have sufficient funds to complete the purchases which he claimed in his August and September 2012 returns. Likewise, the Company was not able to complete the purchase of the motorbikes and tractor and the transaction was eventually cancelled by the supplier.

The TRA also noted that Mr S had told the TRA that he intended that the farm machinery would be leased out while the vineyard project was being developed. However, there was no evidence of any contracts having been entered into or any business proposal relating to the alleged activity.

The TRA agreed with the Commissioner's submissions that at best, the steps taken by each disputant could be described as preparatory steps towards the commencement of a taxable activity.

The TRA reaffirmed that commencement work is not sufficient and does not create or amount to a taxable activity. There still must be an activity to which those steps attach (The TRA referred to *Case 7/2012* (2012) 25 NZTC 1-019). In this case, there was no activity which either disputant was carrying on continuously or regularly and which involved or was intended to involve the making of supplies to other persons for a consideration. Instead, Mr S and the Company had a rudimentary proposal for an ambitious development which they did not advance to any extent.

For these reasons, the TRA was not satisfied that the disputants were engaged in any taxable activity during the time that they were registered for GST. The TRA ruled that the Commissioner was correct to cancel their GST registrations and reassess their GST returns to disallow the input tax deductions claimed.

The TRA stated that the requirements for GST registration are not complicated. Furthermore, Mr S claimed to be experienced in GST matters. The TRA was satisfied that a taxpayer of ordinary skill and prudence would have recognised that there was no taxable activity and would have foreseen a reasonable probability or likelihood of a tax shortfall as a consequence of registering for GST in such circumstances and proceeding to claim input tax deduction. As such, the TRA did not consider that Mr S and/or the Company took reasonable care in taking their respective tax positions. On this basis, the disputants are liable for shortfall penalties of not taking reasonable care.

Application of time bar provisions - s 108 and 108B of the Tax Administration Act 1994

Case	TRA 019/15 [2016] NZTRA 08
Decision date	9 August 2016
Act(s)	Section 108 of the Tax Administration Act 1994
Keywords	Tax Administration Act 1994, s 108, s 108B, time bar

Summary

This is a decision of the Taxation Review Authority on a preliminary time bar issue dismissing the disputant's claim in relation to the application of time bar provisions to the assessments in respect of the disputant's 2001-2005 tax years.

Impact

The decision provides clarification on the interaction between ss 108 and 108B of the Tax Administration Act 1994 ("TAA"). In particular, the decision reinforces the wide powers that the Commissioner of Inland Revenue ("the Commissioner") has to reopen the time bar pursuant to s 108(2) of the TAA where the required opinion has been formed.

Facts

This decision concerns preliminary issues raised by the disputant regarding the application of the time bar provisions in relation to a challenge commenced in 2015.

In October 2006 an investigation was commenced into the disputant's tax affairs for various income tax years including the 2001-2005 tax years. Following a lengthy investigation, the Commissioner commenced the disputes process in March 2010.

In October 2010 during the conference phase of the disputes process, a notice of time bar waiver ("the waiver") was signed. The waiver recorded that the existing time bar for the 2001-2005 tax years of 31 March 2011 would be waived for 12 months to 31 March 2012.

In August 2013 the Commissioner issued a Statement of Position in which she contended that the disputant's taxable income had been understated and that she was able to reopen the time bar for the relevant tax years on the grounds that the returns were fraudulent or wilfully misleading or alternatively they failed to mention income.

Following the conclusion of the disputes process the Commissioner made amended assessments on the basis that:

1. amounts deposited into various business and personal bank accounts were the disputant's assessable income as dividend income; employment income; income under ordinary concepts; or beneficiary income from a trust; and
2. one or other of the time bar exceptions in s 108(2) of the TAA applied to allow the Commissioner to amend the disputant's self-assessments so as to increase the amount assessed.

Decision

Onus of proof

The disputant contended that, as the Commissioner alleges evasion in terms of s 141E of the TAA, the onus of proof rests with the Commissioner in accordance with s 149A(2) of the TAA.

Judge Sinclair held that the onus of proof rests on the disputant because the Commissioner relies on both of the exceptions in s 108(2) of the TAA (one of which does not rely on fraudulent or wilfully misleading conduct). Notwithstanding the above, Judge Sinclair noted that the question of onus is irrelevant given that the Authority is not being asked to make any evidential findings in this preliminary matter.

Issue 1

Judge Sinclair, having noted that ss 108 and 108B of the TAA perform different functions, found that by signing the waiver the parties agreed to delay the time bar specified in s 108 of the TAA for a period of 12 months. Her Honour did not consider that by agreeing to the waiver the parties agreed to a consensual limitation period which cannot be extended.

Judge Sinclair considered that there is no restriction under s 108B of the TAA as to the circumstances when the Commissioner and a taxpayer can agree to a time bar waiver. Her Honour agreed with the Commissioner that it would be an absurd situation if a taxpayer could agree to a waiver which then imposed a limitation period that had the effect of removing the ability of the Commissioner to lift the time bar where tax returns filed by a taxpayer were later found to be fraudulent or wilfully misleading or that assessable income had not been mentioned.

Judge Sinclair did not agree with the disputant's submission that s 108B(1B) of the TAA indicates 'implicitly' that the extended period provides a limitation to any disputed matter known to the parties. Judge Sinclair found that this subsection relates specifically to circumstances where the ground was not identified and known to the parties and that, as such, it does not follow that where a ground is known, the parties have agreed to a new limitation period.

Judge Sinclair also noted that s 108(3) of the TAA makes it clear that the time limits which apply are those set out in s 108(1) and (2) of the TAA.

Issue 2

Judge Sinclair considered the history of the time bar period under s 108(2) of the TAA and, in particular, the provisions of the Land and Income Tax Amendment Act 1968 ("the 1968 Act"). Pursuant to the 1968 Act, the time bar period was amended from 10 years to provide that (where the Commissioner has formed the required opinion) it shall be lawful for the Commissioner to amend an assessment to increase the amount at any time. Judge Sinclair found that the purpose of the amendment was clearly to remove any time limitation period which would bar the Commissioner from amending an assessment where s 108(2) of the TAA applied.

Judge Sinclair disagreed with the disputant's submission that the calculation of the four year period under s 108(1) of the TAA should be fixed from the date the Commissioner formed the required opinion. In this regard Judge Sinclair considered the text of s 108(2) of the TAA to be clear and unambiguous in its meaning - no time period is specified and nor can one otherwise be implied.

Issue 3

Judge Sinclair, noting that the Commissioner has wide powers under s 108(2) of the TAA, did not consider that the Commissioner's exercise of her right to make amended assessments in any way breached her obligation under s 6 of the TAA to maintain the integrity of the tax regime.

High Court held that the Commissioner's opinion in section 108(2) of the Tax Administration Act 1994 must be determined by the hearing Authority on a de novo basis

Case	Edwards v Commissioner of Inland Revenue [2016] NZHC 1795
Decision date	5 August 2016
Act(s)	Tax Administration Act 1994, ss 108, 138E, 138P and 141E
Keywords	Honest opinion, fraudulent or wilfully misleading, returns, time bar, de novo hearing and evasion

Summary

This is an appeal to the High Court against the Taxation Review Authority's ("TRA") finding that the Commissioner of Inland Revenue ("the Commissioner") was correct to hold the opinion that the appellants' tax returns were fraudulent or wilfully misleading pursuant to s 108(2) of the Tax Administration Act 1994 ("TAA"). The Commissioner cross-appealed the TRA's finding that the appellants had not committed evasion.

The High Court held that the TRA was wrong to restrict her reconsideration of the Commissioner's time bar ruling to whether the Commissioner's opinion was honestly held and reasonably available on the evidence. Williams J concluded that the TRA ought to have reviewed the ruling de novo.

Williams J dismissed the Commissioner's cross-appeal because Williams J considered that the TRA was right to come to the conclusion that the Commissioner had not proved Mr Edwards was dishonest as that conclusion was very much open to her on the evidence.

Impact

This decision confirms the approach taken in *Commissioner of Inland Revenue v Legarth* [1969] NZLR 137 (CA) ("*Legarth*"). The TRA stands in the Commissioner's shoes in all respects when considering a challenge in relation to the opinion formed under s 108(2) of the TAA and can come to its own opinion as if it is the Commissioner.

Facts

In April and May 2014, the Commissioner reassessed the appellants' income tax for the tax years 2004-2008. She found they had made impermissible deductions from declared incomes in those years, which were for premiums paid by way of promissory notes to a "captive insurance company" they planned to establish.

The Commissioner re-opened the time bar in accordance with s 108(2) of the TAA because the appellants' tax returns were either fraudulent or wilfully misleading. The Commissioner also imposed on the appellants evasion shortfall penalties in accordance with s 141E of the TAA or, alternatively, gross carelessness shortfall penalties in accordance with s 141C of the TAA.

The appellants challenged the Commissioner's decision to re-open the time bar, as well as the imposition of the shortfall penalties. On 8 June 2015 the TRA upheld the Commissioner's decision to re-open the time bar and to impose a gross carelessness penalty on the appellants (*Case 9/2015* [2015] NZTRA 09, (2015) 27 NZTC 3-008). The TRA considered the Commissioner had not established evasion.

The appellants appealed to the High Court against the TRA's finding on time bar. The Commissioner cross-appealed the TRA's finding on evasion.

Decision

The standard for re-opening the time bar in s 108(2) of the TAA

On appeal, Mr Lennard submitted that the TRA was wrong to refuse to review the Commissioner's time bar ruling on a de novo merits basis. Mr Lennard submitted that the leading authority (plus binding on the High Court) for his proposition is *Legarth* where the Court of Appeal held that the Taxation Review Board ("the Board") was required to review substantively the opinion of the Commissioner even though s 24 of the Land and Income Tax Act 1954 (equivalent to s 108(2) of the TAA) was subjectively worded.

The Commissioner submitted that the TRA had applied the correct review standard. The taxpayer must show that the Commissioner's opinion was not honestly held, that she had applied a wrong legal test or that the opinion was simply not reasonably open to her on the evidence. The Commissioner submitted that *Legarth* no longer controlled the review standard in challenges to time bar decisions in light of changes to the legislation and subsequent Court of Appeal authorities such as *Auckland Institute of Studies Ltd v Commissioner of Inland Revenue* (2012) 20 NZTC 17,685 (HC) and *Wire Supplies Ltd v Commissioner of Inland Revenue* [2007] NZCA 244, [2007] 3 NZLR 458.

Williams J considered that *Legarth* was clearly right in terms of the construction of s 24(2) and s 18(2), and that the intention of the legislature must have been that whatever decision-making authority vested in the Commissioner also vested in the Board when an objection was lodged. The combined effect of s 108(2) of the TAA and s 16(2) of the Taxation Review Authorities Act 1994 ("the TRAA") is accordingly the same as s 24(2) and s 18(2) in *Legarth*.

The Commissioner also relied on the effect of s 138P of the TAA. Williams J considered that s 138P could not be said to impliedly repeal s 16(2) of the TRAA. The wording of s 138P does not negate the effect of s 16(2), but simply adds a "procedural twist". The TRA could no longer be said to have the direct powers of the Commissioner, but it may direct the Commissioner as if it did have such powers and the Commissioner must comply.

Williams J held that the TRA was therefore wrong to restrict her reconsideration of the Commissioner's time bar finding to whether the Commissioner's opinion was honestly held and reasonably available on the evidence. Instead the TRA ought to have reviewed the ruling de novo.

Correct test for "evasion or similar act" in s 141E of the TAA

Williams J considered that the TRA was well aware of the correct test for subjective recklessness, as well as the inferences that the Commissioner invited the TRA to draw.

Mr Edwards and Ms Patterson's view that the deductions were claimable were not directly challenged by the Commissioner in cross-examination, which would have been good practise. However, Williams J was not prepared to find the Commissioner

was under an obligation to do so in terms of s 92 of the Evidence Act 2006, but did consider that the failure to test this issue with either witness inevitably made the argument that the TRA's conclusion was irrational more difficult to sustain.

Relying on *Edwards (Inspector of Taxes) v Bairstow* [1956] AC 14 (HL) and *Faryna v Chorny* [1952] 2 DLR 354 (BCCA), the Commissioner argued that the preponderance of the evidence so irresistibly pointed to Mr Edwards' knowledge of the risk that the deductions were unlawful, that the failure to directly attack his honest belief through cross-examination ought not to prevent Williams J from rejecting the TRA's finding. The High Court disagreed.

Williams J considered that the TRA was right to come to the conclusion that the Commissioner had not proved Mr Edwards was dishonest as that conclusion was very much open to her on the evidence. Without having had the same advantage, Williams J did not feel that he was in any better position to assess credibility than the TRA was. In light of this, Williams J was not prepared to overturn the TRA's findings so the Commissioner's cross-appeal was dismissed.

Statutory Interpretation: section CC 1 of the Income Tax Act 2007

Case	Commissioner of Inland Revenue v Vector Limited [2016] NZCA 396
Decision date	12 August 2016
Act(s)	Income Tax Act 2007
Keywords	Capital, revenue, other revenues, statutory interpretation

Summary

The Court of Appeal has found that the words "other revenues" in s CC 1(2) of the Income Tax Act 2007 ("the Act") do not capture amounts that are capital in nature.

Impact

The decision clarifies the law in relation to payments derived from the use of land. The Court of Appeal has indicated that some of the payments received in similar circumstances to this case will now be captured by s CC 1B of the Act.

Facts

The respondent ("Vector Ltd") sold access rights to a tunnel for $50 million ("Southern Access Rights") and rights to its overhead corridor through which electricity is to be distributed for approximately $3 million ("Northern Access Rights") to the national grid operator, Transpower New Zealand Ltd ("Transpower"). The combined sum Transpower paid Vector was circa $53 million ("the Consideration").

Whether the Consideration was on capital or revenue account turned on whether it was deemed income under s CC 1 of the Act.

The High Court found that the Consideration was a non-taxable capital receipt (*Vector Ltd v Commissioner of Inland Revenue* [2014] NZHC 2069, (2014) 26 NZTC 21-096). The Commissioner of Inland Revenue ("the Commissioner") appealed that decision.

Decision

The Commissioner's appeal was dismissed on all grounds. The Court found that the High Court was correct in its analysis of the nature of the legal rights and responsibilities under the June 2010 agreement between Vector and Transpower. The Court dealt with Issues 1 (Whether the text of s CC 1 and its context in the scheme of the Act establish that the purpose of the section is to include in a taxpayer's income amounts "derived … from" the use of "land" that it "owns") and 2 (Whether the High Court erred in its interpretation of the term "other revenues" in s CC 1(2)(g), namely that it does not include amounts of a capital nature) together and Issue 3 (Whether the High Court erred in its analysis of the nature of the legal rights and responsibilities retained and/or given away by the agreement between Vector and Transpower) separately.

Issues 1 & 2

The Court concluded that there has never been a coherent, overarching scheme in s CC 1 (that the amounts derived by a landowner for letting another use its land is taxable). The Court finally noted that if Parliament had intended a scheme of the nature contended by the Commissioner, that is, capturing all amounts derived from specified uses of land short of disposal, it would have said so.

As for issue 2, the Court found that the lack of a coherent scheme or approach is evident from the listed amounts in s CC 1(2), noting that the listed amounts do not naturally fall into a group with common characteristics.

The Court made four points on this issue. In brief they are:

1. The listed amounts in subs (2) have been specifically selected. Their inclusion in a list does not create a general remit to treat all proceeds from the use of land as income, regardless of their treatment on ordinary taxation principles. Parliament could have used simple and clear language to describe a class of this nature. The items are diverse in nature. No ejusdem generis class emerges.
2. It is significant that Parliament chose, deliberately, the concluding words "other revenues" and not for instance, "other like amounts".
3. The best approach is to focus on the words "other revenues" read in their natural sense. In context, the words "other revenues" are there to capture revenue receipts.
4. The Commissioner's approach, that "other revenues" can include amounts that are on capital account, would effectively render subs (2) otiose as any "amount" derived as per subs (1) would be an "amount described in subsection (2)" however, that cannot have been intended.

The Court concluded that the High Court was correct in finding that the term "other revenues" used in s CC 1(2)(g) does not include amounts of a capital nature.

Issue 3

The Commissioner's alternative submission was that in reality the Consideration was disguised rent paid in advance as a lump sum.

In rejecting the Commissioner's submission the Court made the following points:

1. In terms of the Northern Access Rights, there are permanent impairments on Vector's ability to use its assets.
2. In terms of the Southern Access Rights, because the agreement between Vector and Transpower extended beyond the life expectancy of the tunnel, it was economically permanent.
3. There is no ability for Vector to regain its interest for non-payment of the Consideration, because that Consideration has already been paid.

The Court concluded that there was effectively permanent disposition of property interests.

The appeal and cross-appeals were dismissed.

Impact of bankruptcy on ability to bring challenge proceedings

Case	David Ian Henderson v The Commissioner of Inland Revenue [2016] NZHC 1987
Decision date	24 August 2016
Act(s)	Insolvency Act 2006, Goods and Services Tax Act 1985, Income Tax Act 2007
Keywords	Bankruptcy – standing – s 101 Insolvency Act 2006, s 61 Goods and Services Tax Act 2006, s HD 15 Income Tax Act 2007

Summary

The High Court dismissed an appeal from a Taxation Review Authority ("TRA") decision, upholding the TRA's decision to dismiss a challenge proceeding on the basis that:

1. The disputant, as a bankrupt, had no standing to bring the proceeding; and
2. Even if the standing issue was not correct, the Commissioner of Inland Revenue ("the Commissioner") was correct to assess the appellant as agent for the purposes of s HD 15 of the Income Tax Act 2007 ("ITA") and s 61 of the Goods and Services Tax Act 1985 ("GST Act").

Impact

The decision ultimately turns on the issue of standing however the case also provides some High Court commentary on s 61 of the GST Act and s HD 15 of the ITA in its current form.

Facts

The appellant was the manager of Property Ventures Limited ("PVL"), which acted as the representative member for a number of companies that were part of a GST group of companies ("the GST Group"). FM1, FM3 and PVIL were included in the GST Group. The appellant was a director of each of FM1, FM3 and PVIL.

By April 2008 PVL and a number of its subsidiaries had substantial outstanding liabilities to creditors (including the Commissioner). PVL was also owed significant amounts by some of its subsidiaries, including FM1, FM3 and PVIL. The directors of PVL decided to sell off properties owned by FM1, FM3 and PVIL to generate funds to pay PVL's debts. To this end the appellant negotiated agreements for sale of the properties to the Christchurch City Council ("the Sale").

Back in July 2006 PVL had provided a financial guarantee to a finance company in relation to the indebtedness of the largest subsidiary in the GST Group. In July 2008 the finance company placed the subsidiary into receivership.

The directors of PVL were concerned that if the subsidiary's receiver became aware of the sale of the properties to the Council, it would take action to ensure it received the net sale proceeds and appoint receivers to all of PVL's assets.

It was decided to incorporate ILR Holdings Limited ("ILR") and for that company to acquire shares in certain subsidiaries of PVL (including FM1, FM3 and PVIL) and for ILR to acquire, by way of assignment, the intercompany debts owed by those subsidiaries to PVL.

ILR was incorporated on 1 August 2008 with the appellant as its sole director. On the same date, the Council signed sale and purchase agreements with FM1, FM3 and PVIL.

On 4 August 2008 PVL assigned intercompany debts totalling $14,932,498 to ILR. On the same day PVL transferred a number of its shares in FM1, FM3 and PVIL to ILR for nominal consideration. Also on that date, the Commissioner received separate applications from PVL (dated 31 July 2008) seeking to exclude 8 companies from the GST group, including FM1, FM3 and PVIL.

On 6 August 2008 the solicitors acting for FM1, FM3 and PVIL issued GST invoices for the sale of the properties to the Council. The sales settled on 8 August 2008. The proceeds were used to discharge registered mortgages in relation to the properties and pay costs of sale. The net proceeds were then paid to ILR.

The companies were left with no remaining funds or assets left in FM1, FM3 or PVIL to pay the GST liabilities due on 28 September 2008. When FM1, FM3 and PVIL were placed into liquidation in June 2010, their GST liabilities totalled $1,779,568. PVL was placed in liquidation the following month.

On 25 August 2009 the appellant was assessed as agent for the companies' GST liabilities incurred in relation to the Sales. The appellant was adjudicated bankrupt in 2010 and the Commissioner filed a proof of debt in the bankruptcy. The Official Assignee ("OA") never admitted, rejected or quantified any of the claims on the basis that there were no funds available to meet any provable debts.

The appellant then brought a challenge proceeding in the TRA disputing the correctness of the GST assessments made against him personally under s 61 of the GST Act.

The TRA found against the appellant on the basis that as a bankrupt he had no standing to bring the challenge proceeding. In the event that she was wrong on that point, the TRA found the requirements of s 61 of the GST Act were met and the assessment made against the appellant as agent for the companies was therefore correct.

The appellant appealed to the High Court.

Decision

While the appellant addressed only a few of the grounds raised in the Notice of Appeal at the hearing, the Court in its decision addressed all points raised by the appellant in his Notice of Appeal and at the hearing.

Application of s 76 of the Insolvency Act 2006 ("IA")

The appellant argued that s 76 of the IA prevented the Commissioner from contesting the challenge as he contended that the challenge was in reality directed specifically to "recover a debt".

Gendall J dismissed this argument and noted that the challenge had in fact been brought by the appellant himself. A separate debt recovery proceeding would be required to enforce payment.

A debt owing but payable in the future is not a contingent debt

The Notice of Appeal raised the issue as to whether the debts were only contingent at the time the appellant was adjudicated bankrupt. The Judge upheld the TRA's finding that a debt which is subject to a challenge is not a contingent debt. His Honour found that the debt was an actual debt presently owing albeit not presently payable due to the challenge being on foot.

This finding was supported by the policy underpinning s 109 of the Tax Administration Act 1994 ("TAA") and the fact that s 138I(2)B of the TAA provides that the Commissioner may require a disputant to pay all tax in dispute that is subject to a challenge in certain circumstances.

Challenge proceeding constitutes "property" under s 101 of the IA

A further ground raised in the Notice of Appeal but which the Judge considered had not been furthered in written or oral submission was an argument that challenge proceedings are not "property" under s 101 of the IA and so does not vest in the OA on adjudication.

Gendall J supported the TRA's reasoning that the term property is defined widely and tended to the view that the TRA did not err in finding that the challenge right was property which vested in the OA. His Honour did not however find it necessary to make a final decision on that aspect given his conclusions on the other grounds of appeal.

Right to bring challenge not assigned by the OA to the appellant

The appellant also chose not to further in his submissions the listed ground of appeal on the issue of whether the OA had assigned the right to issue challenge proceedings to the appellant, or otherwise had consented to the appellant doing so.

His Honour found there was little in this ground and found the TRA was correct in concluding the appellant had no standing to commence the challenge proceedings.

The existence of an "arrangement"

Gendall J noted the appellant appeared to argue there was no arrangement either because the transfer of assets satisfied pre-existing debts or because the appellant unilaterally chose to pay ILR.

His Honour found the TRA was correct to determine there was an arrangement entered into and to reject the appellant's arguments. The Court had no doubt the steps were taken as part of an overall plan to strip the companies of funds with the effect of rendering them unable to meet their tax liabilities.

The effect of the arrangement – companies unable to meet their tax liabilities

Gendall J was left in no doubt that the inability of the companies to meet their GST debts was the end result of the arrangement and an effect irrespective of any other motives which may have existed in relation to the arrangement. The Court found the TRA was correct to find this requirement under s 61 of the GST Act was satisfied.

Reasonable conclusion that a purpose of the arrangement was to render the companies unable to meet their tax liabilities

Gendall J noted this required an objective examination. His Honour found the TRA was correct to find objectively that it was a purpose of the arrangements put in place that each company transacted so the effect would be the company in question could not meet its GST liability.

Reasonable conclusion that a director making reasonable enquiries could have anticipated the GST liabilities would, or would likely, be required to be met

Gendall J noted that again the test here is an objective one. The appellant admitted in an Agreed Statement of Facts that he was aware at the time the sale and purchase agreements were entered into that 12.5% GST was required to be added to the agreed purchase prices. The Court found that admission led to little doubt that at the time of the arrangement the

appellant had presumably made reasonable enquiries and anticipated that GST liabilities arising at the time of supply of the properties under the sales to the Council would need to be met.

Conclusion

The Court found the appellant was unable to establish that the TRA erred in its decision and therefore dismissed the appeal, awarding the Commissioner costs on a 2B basis.

Crediting may not constitute payment

Case	Lesley William Fugle v Commissioner of Inland Revenue [2016] NZHC 1997
Decision date	25 August 2016
Act(s)	Subpart EH Income Tax Act 1994 and 138G Tax Administration Act 1994
Keywords	Base price adjustment, financial arrangement rules, final payment, payment

Summary

The High Court held that crediting an amount to a shareholder's current account in respect of an existing liability in circumstances where there were insufficient funds for the shareholder to draw down the full amount, did not constitute payment. Because there was no final payment under the financial arrangement in this case, a base price adjustment ("BPA") was not required.

Impact

Where the crediting of a shareholder account reflects a pre-existing liability and all the funds are not actually available to be placed unreservedly at the disposal of the account holder, the crediting of a current account may not constitute a final payment under a financial arrangement, so as to trigger a BPA.

The decision is also an example of the difficulty in preventing new documents being introduced before a hearing authority under s 138G of the Tax Administration Act 1994 ("TAA").

Facts

The appellant is the sole shareholder and director of Bathos Properties Ltd ("Bathos"). In 1986, Bathos became indebted to the Bank of New Zealand ("BNZ"). The appellant personally guaranteed the lending and Bathos gave BNZ a debenture over its assets as security. Bathos then ran into financial difficulty and BNZ appointed receivers.

The resulting litigation between BNZ and the appellant was settled by an agreement whereby the appellant agreed to pay BNZ $90,000 in return for Bathos' debt to BNZ, which amounted to $2,659,442.06, being assigned to him. The agreement was formalised in a Deed of Admission of Liability and Settlement ("Deed").

Between 1996 and 2004, Bathos did not trade. In 2004, after Bathos commenced trading, it credited $2,659,442 (being the amount of the debt assigned under the Deed) to the appellant's current account.

Financial statements for Bathos for the 2005 to 2007 income years showed net drawings over this three year period of $2,238,592. The assigned debt was not recorded in the financial statements as a term liability.

The appellant returned no taxable income for the 2001 to 2010 income years. The appellant had no bank account. He did not draw a salary from Bathos and drew money from his current account to fund family living expenses.

The Taxation Review Authority ("TRA") found that the payment by the appellant of $90,000 to BNZ to acquire Bathos' debt was a financial arrangement for the purposes of the accrual rules in Part EH of the Income Tax Act 1994 ("ITA"). The TRA further found that the financial arrangement had matured in 2005, which meant a BPA was required in that year. The appellant appealed to the High Court.

Decision

The appeal was allowed.

Was the credit to the current account a "payment"?

Cull J distinguished the authorities relied on by the Commissioner of Inland Revenue ("the Commissioner") where funds which had been credited into current accounts were held to be "payments" for the purpose of paying dividends and

director's fees. She noted that in those cases, the dividends or salary credits constituted an allocation of income or retained earnings which were not previously payable. She also noted that crediting to a current account will only amount to payment where it is done with the shareholder's consent.

In this case, Cull J found that the crediting to the appellant's current account was recognition of an existing liability, there had been insufficient funds available to pay the appellant had he demanded immediate payment of the full amount, and there had not been a decision by Bathos to make a payment to the appellant in the 2005 tax year. Accordingly, the Court held that the crediting to the current account in the present case did not constitute a "payment".

Had the financial arrangement matured?

Cull J did not accept the Commissioner's submission that even if there were insufficient available funds the appellant could have drawn down funds from related entities and written off the remaining $690,000 as a bad debt. The Court again distinguished the cases relied upon by the Commissioner, noting that in those cases money was placed unreservedly at the disposal of the directors or shareholders, whereas in the present case there was not a sum of money to constitute payment, but rather an assignment of debt. The Court found that because there had been no final payment under the financial arrangement, a BPA had not yet been triggered. Accordingly, the Court found that it would be premature to tax the full credit sum in the 2005 tax year as no taxable event had occurred in that year.

Should the application by the appellant to admit documents have been allowed?

On the day of the TRA hearing, the appellant sought leave to produce further accounting documents dated between 1992-2003. The TRA relied on s 138G(2) of the TAA to refuse to admit the documents. The TRA held that there was a new issue being raised, that the documents could have been located before the hearing and that there was no manifest injustice to the appellant. Leave was refused under r 8.31 of the District Court Rules to admit the documents because of the risk of prejudice to the Commissioner.

The High Court found that the TRA erred in refusing to admit the documents. Cull J held that the documents did not raise a new issue, but corroborated the evidence of the appellant that there was no payment in 2005. Her Honour considered that, as the documents were supportive of the appellant's position, it was in the interest of fairness that they should be admitted. Any prejudice to the Commissioner could have been overcome by adjourning the hearing. As the TRA is a Commission of Inquiry, the Judge found that it should have received the documents as evidence that would have assisted it to deal effectively with the subject of the enquiry under s 4B(1) of the Commissions of Inquiry Act 1908.

Did the crediting to the appellant's account take place in 2005 or prior, and if prior to 2005, what significance, if any, should be attached to the date of crediting?

The Court noted that the amount of the assigned debt had been owing to the appellant for a decade. Referring back to her earlier finding that the crediting did not constitute "payment", Cull J went on to say that the only significance which could be attached to the date of the retrospective crediting to the appellant's account was that Bathos recommenced trading in 2005. So Bathos was then in a position to enable the appellant to draw down part of the debt owing to him.

Other matters

Receipt of benefits under the accrual rules

The Court did not accept the Commissioner's submission that the movements of benefits have to be taken to tax under the accrual rules. The Court noted that there is no reference to benefits within the accrual rules under the ITA.

Obligation on disputant to show that the assessment is wrong and by how much

The Court was satisfied that the appellant had discharged the onus of proving why the Commissioner's assessment was wrong.

Alternative spreading method

The Court was not satisfied that the Commissioner's proposed alternative spreading method in s EH1(2)-(7) was applicable. It noted that it was now open to the Commissioner to reassess the appellant's income tax liability, in light of the High Court's decision.

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