Taxation of property transactions: A critical analysis of section 67 of the Income Tax Act 1976

John Prebble*

Section 67 of the Income Tax Act 1976 taxes as income certain gains on the sale of land that would ordinarily be classed as capital. A recent Consultative Committee has proposed that the section should be repealed, and that a severely limited core of its charging effect should be transferred to other provisions of the Act. A final decision to repeal section 67 has not been made. An alternative is to strengthen and to make more rational the existing section. In this article, the author argues that section 67 contains a number of flaws. On the assumption that the section may be retained, the author identifies and analyses the shortcomings that he sees in the section, and recommends remedial measures.

I INTRODUCTION

New Zealand has no general capital gains tax. However, there are several provisions in the Income Tax Act 1976 that tax as income certain gains that would ordinarily be classed as capital. Prominent among these provisions is section 67 of the Act. Among other things, section 67 taxes profits on the sale of land if the owner embarks on a scheme of subdivision of the land within ten years of acquiring it. Section 67 was introduced in 1974 as section 88A of the Land and Income Tax Act 1954 because it was thought that people were able too easily to make untaxed speculative profits on land transactions. However, the reach of the section goes a good deal further than the requirements of this original policy dictate.

In 1989 the New Zealand government established a Consultative Committee to advise on the adoption of a capital gains tax. The Committee was to respond to a *Consultative Document on the Taxation of Income from Capital.*[1] Subsequently, the proposal for a capital gains tax was abandoned. However, the Committee was asked to remain in office in order to recommend structural improvements to the Income Tax Act, particularly to its core provisions. The Committee recommended that section 67 should be repealed, and other provisions of the Act strengthened to catch some of the gains now caught by section 67, perhaps broadly to be described as speculative or income-like gains.[2]

---

* Professor of Law, Victoria University of Wellington.

1 New Zealand Treasury for the Minister of Finance, New Zealand Government Printer, 1989.

2 The Consultative Committee on the Taxation of Income From Capital (The Valabh Committee) *Tax Accounting Issues* (New Zealand Government Printer, Wellington,

The government advised that it agreed in general with the recommendation of the Committee, but "is further considering the detail of the Committee's proposals to ensure that the net impact of these reforms conforms with the Government's revenue strategy".[3] This article does not look at the merits of that Committee's proposal. Rather, it considers the alternative possibility of retaining section 67. In that light, the article examines the drafting and effect of the section.

The article finds numerous shortcomings in section 67, of varying degrees of seriousness. In some cases, the apparent policy of Parliament has not been carried into effect. In others there are inconsistencies that cannot be explained rationally between different parts of the section. Thirdly, concepts have been imported from other parts of the Income Tax Act that do not sit easily in section 67. Though there are numerous flaws in the section, none of them should be described as fundamental. In most cases the shortcomings that are identified could be remedied by amendment of the section, should Parliament be so inclined, though there are one or two problems that are not obviously amenable to repair.

The article deals in parts II, III, IV, and V with the charging provisions of the section. Part VI deals with the provisions of section 67 that apply to transactions between associated persons, part VII with accounting problems, and part VIII with avoidance. Part IX considers section 67 (5), (6), and (9), which carve out certain exceptions to the charging provisions.

II PURPOSE OF THE TAXPAYER

Section 67 contains seven charging paragraphs, in subsection (4). The first of these, the simplest, is section 67(4)(a), which taxes "All profits or gains derived from the sale or other disposition of any land if the land was acquired for the purpose or intention, or for purposes or intentions including the purpose or intention, of selling or otherwise disposing of it".

This paragraph broadly speaking is successful in its objective: to catch profits from the sale of land where the land was acquired with the intention of selling it. That is, with perhaps one exception, section 67(4)(a) remedies the shortcomings that were found in section 65(2)(e), second limb.

An exception relates to cases where the taxpayer has had a change of purpose, which is illustrated by the case of *Corin* v *Commissioner of Inland Revenue*.[4] The taxpayer had bought some land for sale. He changed his mind about one section of the land, and instead built his own home on it. Later, he sold the home. The Commissioner assessed the profits under a forerunner of what is now section 65(2)(e), which taxed profits from the sale of land "if the property was acquired for the purpose of selling or otherwise

---

1991) 89 ff and *Final Report* (New Zealand Government Printer,Wellington, 1991) 86.

3 Above n 2, *(Final Report)* 127.

4 (1967) 10 AITR 411, Henry J

disposing of it". That is, in material respects the charging words were the same as the words of section 67(4)(a).

Although the property had been bought "for the purpose of selling ... it", Henry J held that the intervening change of purpose took the profits outside the Act. There is a strong argument that *Corin* v *Commissioner of Inland Revenue* was wrongly decided, on the basis that it seems to fly in the face of the clear words of the Act. On the other hand, perhaps Henry J's approach is reinforced by the fact that Parliament enacted section 67(4)(a) without making provision to reverse the effect of the case. Accordingly, it may be that a change of purpose after the acquisition of land denies effect to section 67(4)(a).

In most cases where, as in *Corin* v *Commissioner of Inland Revenue*, the changed purpose is to build one's own home on the land the possible lacuna in section 67(4)(a) is not material. The reason is that, by virtue of section 67(5)(b), there is an exemption for profits from the sale of land that includes a dwelling/house occupied by the taxpayer and members of his family. However, a taxpayer could still wish to deploy the *Corin* arguments where his changed purpose had not materialised in a completed and occupied dwelling/house, or where his changed purpose was something else.

III VULNERABLE BUSINESSES

Section 67(4)(b), (ba) and (c) catch the profits on the sale of land by, respectively, land dealers, land developers, and builders where the land has been held for less than ten years, or, without time limit, where the land was acquired for the business purposes of the taxpayer. For example, section 67(4)(b)(i) applies to land bought by land dealers for their dealing business, and section 67(4)(b)(ii) applies to land bought by dealers for any purpose, but sold within ten years. The same pattern of sub paragraphs (i) and (ii) is found in section 67(4)(ba) and (c). These paragraphs replace, in respect of land transactions, the first limb of what is now section 65(2)(e) of the Act, which formerly caught profits on the sale of land "if the business of the taxpayer comprises dealing in such property".

The former first limb, and paragraphs (b), (ba), and (c), reflect the fact that someone who deals in property may be tempted to avoid tax by arguing that one transaction or another that he engages in is on private account, even though the transactions involve property of a kind in which he habitually deals. The policy of the provisions is to frustrate this kind of avoidance, simply by deeming all transactions in property in which the taxpayer deals (or, in the case of paragraphs (a), (ba) and (c) all disposals within ten years of acquisition) to be on revenue account.

Given that the policy of the provisions is as set out in the previous paragraph, it makes no sense to deal with different forms of dealing by different rules. Thus, whether one buys and sells land in the same form, or sells land after developing it or building upon it, such dealer-catching provisions should apply, and they should apply in the same manner. This appears to have been the policy of the predecessor to section 67, which is now represented by section 65(2)(e). That paragraph formerly assessed to tax profits derived from the sale of property "if the business of the taxpayer comprises dealing in such property". Probably, the draftsman used the word "dealing" to include all forms of buying and selling. It is hard to believe, for example, that in respect of the business of buying and selling land the draftsman intended to catch people who buy and sell land in the same form, but to omit property developers who buy bare land and subdivide and provide services to it before sale.

The early draftsman's intention, if it was his intention, has been overturned in the current form of section 67. First, section 67 as originally enacted separated builders from developers. Secondly, Bisson J held in *Henderson* v *Commissioner of Inland Revenue*[5] that "dealing in land" does not include the activities of a developer who undertakes earthworks, roading and other operations associated with subdivisional work. As a result, there are separate provisions to deal with dealers, developers, and builders.

A neater, and conceptually more elegant, approach would be to define "dealer" to include "developer", "builder", and any other entrepreneur whose business includes buying and selling land, and to have one rule to govern all dealers, as defined in this comprehensive manner. This is not merely a matter of elegance of drafting. The present piecemeal approach has resulted in several mistakes, where the law as drafted does not carry a consistent and logical policy into effect.

A Builders who do not Effect Improvements

Section 67(4)(c) catches profits on the disposition of land where the taxpayer carried on "the business of erecting buildings, and the taxpayer ... carried out ... any improvements, not being improvements of a minor nature, to that land ...".

First, and as an aside, one should draw attention to the tautology of "business of erecting buildings" when "business of building" or "building business" would surely suffice, but this is no more than a drafting point.

More importantly, section 67(4)(c) is inaccurately aimed. It has two targets: builders who ordinarily buy land and build on it, and then sell the result (chronic speculators), and builders who usually build for a customer, on the customer's land, but who occasionally, or on one occasion only, buy land and build on it speculatively (occasional speculators). For both chronic and occasional speculators there are two possible factual situations: the builder either has, or has not, effected improvements to the land. For both types of speculator, section 67(4)(c) operates only in the first set of circumstances, that is, where the builder has carried out improvements.

i Chronic speculators: unimproved land

One result is that section 67(4)(c) does not catch a chronic speculator who sells land without improving it, or sells land after making improvements of only a minor nature. This result is inconsistent with the position of the dealer or developer who, by virtue of section 67(4)(b) or (ba), will be caught simply as a consequence of buying and selling

5 (1982) 5 TRNZ 830.

the land within ten years. That is, the fact that the business of the chronic speculator is building, and not developing or dealing, makes him less vulnerable to section 67.

There can be no policy justification for this distinction. How did it come about? A probable explanation is that the draftsman of section 67 assumed that a chronic speculator is in fact a dealer in land, and is therefore caught by section 67(4)(b) in any event. That would have been a reasonable assumption. But we now know from *Henderson* v *Commissioner of Inland Revenue* that someone who buys land and sells it after working on it is not a dealer. Thus, the chronic speculator is no more a dealer than is the developer. The position in respect of the developer was remedied by the addition of section 67(4)(ba), but nothing was done about the chronic speculator, presumably because it was not appreciated that the *Henderson* case had implications for builders as well as for developers.

ii *Occasional speculators*

Like chronic speculators, occasional speculators are not caught by section 67(4)(c) if they sell land without improving it, even if the land was bought for the purposes of the building business. Again, it is hard to see the policy justification for this distinction. If land was bought for business purposes, why should it make any difference whether the taxpayer sells it after building on it, as he intended, or before building on it, having changed his mind?

Of course, if a builder buys land for business purposes, and later sells it, the profits are probably caught by section 67(4)(a) (land acquired for the purpose of disposal) in any event. But similar considerations apply to dealers or developers who acquire land for their businesses, and yet Parliament saw fit to enact the additional charging provisions of section 67(4)(b)(i) and section 67(4)(ba)(i) to apply to dealers and to developers where land has been bought for a dealing or development business. No doubt these provisions were enacted as a second arrow to the bow of the Commissioner, who may find it easier to establish that land was bought for business purposes than that it was bought for disposal. In this context there is no reason to distinguish dealers and developers on one hand from builders on the other, as the Act does.

iii *Pure builders*

The reasons for the curious effects of section 67(4)(c) become apparent when one considers the case of the builder who builds only for customers, on their land, and who never buys land for the purposes of his building business. Presumably, Parliament intended that such "pure" builders should not be subject to the ten-year automatic assessment rule, because they are not dealers in land by any definition of the word "dealer". Consequently, section 67(4)(c) is so drafted that if a pure builder buys and sells land within ten years, without improving it, he is not caught by section 67(4)(c). That result is consistent with the policy of section 67. A pure builder should be no more vulnerable to section 67 than a plumber, an accountant, or a physician.

The policy behind section 67(4)(c) is apparent. Parliament no doubt thought that builders, like dealers, are well placed to disguise profits on sales of land that should be on revenue account but that are claimed to be on private account: therefore builders were made vulnerable to the automatic, even arbitrary, operation of the rules of section 67(4)(c). Because of the unfairness of treating pure builders as if they were dealers in land Parliament limited the ambit if section 67(4)(c). But this limitation has had the unexpected effect of allowing all types of builders to escape from section 67(4)(c) unless they effect improvements to the land.

Section 67(4)(c) is deficient in what it does not cover, as explained above. At first sight, the section is also deficient in what it does cover, in that some transactions caught by the paragraph appear to be outside the spirit of section 67. If a builder acquires land and builds a house on it for his family home he is caught by section 67(4)(c) (ii) if he sells within ten years, but he will ordinarily be exempted from tax by section 67(5)(b). However, if he builds a house for his parents or children he is vulnerable to section 67(4)(c)(ii) if he sells the land within ten years, though not if he buys an existing house for the same purpose, provided that he does not renovate it.

The deficiency is more apparent than real. Assuming that one has a provision like section 67 at all, it is not unreasonable for the rule to cover builders. And a builder who erects a house for private purposes, but who later sells the house, would escape tax not only on the value of the land but also on the value of his labour if both the land and the improvements were not taken into account in assessing taxable profits.

The problem with section 67(4)(c) is that in ensuring that it captures a particular type of profit that is within the policy of section 67 the draftsman has inadvertently omitted other profits that qualify equally to be within the section. To describe the taxpayer as being in the business of erecting buildings is sensible (if tautologous), but to extend the necessity for erecting buildings to the taxable event (improvement to the land) appears to have been an error.

B Time Limits Applicable to Builders

Section 67(4)(b), (ba), and (c) follow a similar pattern. Where the land is acquired for purposes of the business in question, there is no time limit on the vulnerability of the taxpayer to tax on any profits that may be made on the sale of the land. Where the land was bought for other purposes, taxpayers are free of the section after ten years. However, the ten year period that applies in respect of paragraph (c) is very different from the ten year period that applies in respect of the other provisions.

Paragraphs (b) and (ba) cease to apply ten years after vulnerable land was acquired by the taxpayer. But the paragraph (c) ten year period does not even start to run until any improvements effected by the taxpayer or by an associated person have been completed. That is, a paragraph (c) period can be of any length. Suppose, for example, a builder buys a house as an investment in 1970, and in 1990 she renovates the house for her children to live in while they are attending university, and the house is sold in 1999. The profits are assessable by virtue of section 67(4)(c), even if this is the only purchase and sale of property that the taxpayer has ever carried out. This result appears to be inconsistent with the policy of section 67, and to treat builders more harshly than dealers or developers.

Why is there this inconsistency? The reason seems to be a mistake that is not untypical of the drafting of section 67. The policy behind making section 67(4)(c) apply only where there has been improvement to the land in question is a policy to *limit* the effect of the paragraph. That is, not all builders are caught, only builders who improve land that is vulnerable to the section. However, a glance at section 67(4)(c) can mislead the reader into thinking that the requirement of improvements is part of the *charging* apparatus of the section. Perhaps with this mistake in mind, it may be that the draftsman concluded that the beginning of the vulnerable period for section 67(4)(c) cases should depend not on the time of acquisition of land but on the time of completion of improvements.

C Improvements by Associated Persons of Builders

In a manner similar to other provisions in section 67(4), paragraph (c) applies where either the taxpayer or an associated person of the taxpayer carries on business as a builder. The two requirements of paragraph (c) (acquisition and sale of land and improvements effected to the land) are both linked to the associated persons provision. That is, either or both of the acquisition and sale and the effecting of improvements may be by an associated person rather than by the taxpayer.

However, paragraph (c) is avoided if the associated person who carries out the improvements to the land is not himself or herself in the building business. For example, a taxpayer who is a builder is not caught by the section if a non-builder spouse effects improvements on the taxpayer's land. Likewise, a non-builder taxpayer who is vulnerable to the paragraph by virtue of having a builder spouse is not caught if a second associated person of the taxpayer effects improvements to the land, the second associated person not being in the building business.

The policy of paragraph (c) is that it should apply to a taxpayer even if the taxpayer is not in the building business, provided that an associated person of the taxpayer is in that business. In those circumstances, the taxpayer is vulnerable if the taxpayer effects improvements to the land, even if the taxpayer is not a builder. By the same token, it should not matter if a non-builder associated person effects improvements, assuming that the taxpayer is vulnerable to paragraph (c) by virtue of his status as a builder, or by virtue of the status of another associated person.

D Improvements Before Acquisition of Land

One curiosity of section 67(4)(c) is that the paragraph applies even if the improvements effected by the taxpayer or by an associated person were carried out before the taxpayer acquired the land. The result appears to be that if a builder buys a property that he has worked on in the past, even for an ordinary, arm's length client, the builder becomes vulnerable to section 67 in respect of that property.

The purpose of making section 67(4)(c) apply to cases where improvements are effected before acquisition of the property may have been a desire to gather into the tax net the following kind of case:

1980 Builder buys land.
1981 Builder effects improvements to land.
1982 Builder transfers land to taxpayer, who is an associated person.
1983 Taxpayer sells the land at a profit.

Consider the 1983 sale. As it stands, section 67(4)(c) catches this sale, because there has been an improvement to the taxpayer's land by a builder who is an associated person, notwithstanding that the improvement was effected before the taxpayer acquired the land. However, if the intention of the draftsman was to capture profits derived in this kind of case that intention was misplaced. The reason is that the 1983 sale is caught in any event by section 67(12). Section 67(12) catches profits on sales of land by taxpayers who are associated with people who are vulnerable to section 67, and who have transferred the land in question to their associates without realising, or without fully realising, the profit to which section 67 would apply.

If this analysis is correct it means that the retroactive operation of the improvements provisions in section 67(4)(c) catch some transactions that are outside the policy of section 67, and catch other transactions that are already within the net of the section.

E Developers who Specialise in Minor Work

As mentioned earlier, section 67(4)(ba) was inserted into the Act in order to counteract the effect of *Henderson* v *Commissioner of Inland Revenue*,[6] where Bisson J held that "dealer" does not include a developer who changes the face of land before he sells it. Logically, section 67(4)(ba) should apply to all developers. In fact, it applies only to developers who carry on "development or division of the kind (not being work of a minor nature) referred to in paragraph (e)" of section 67(4).

The primary reference to section 67(4)(e) has no practical effect because section 67(4)(e) does not define or limit the expression "development or division". This lack of effect is just as well because there is no reason of policy to limit section 67(4)(ba) to developers that carry on development of any particular kind.

There is a second, somewhat similar, policy in section 67(4)(ba) that is carried into effect. The paragraph applies only to taxpayers whose development business involves work "not being work of a minor nature". There are two possible interpretations of this limitation. First, and most probably, the effect is that the paragraph does not apply to developers whose business involves work of a minor nature *only*. Secondly, and less probably, the paragraph may not apply to developers whose business sometimes *includes* work of a minor nature.

Whichever way the paragraph should be interpreted, no policy of tax law justifies this restriction on its ambit. If developers should be subject to the vulnerable occupations provisions of section 67 (and to be consistent with the broad policy of section 67 they no doubt should be) there is no reason to exempt developers whose

---

6 (1982) 5 TRNZ 830.

business involves only minor work (perhaps taxpayers who specialise in small developments), and even less reason to exempt people whose developments sometimes involve minor work, if that is the effect of the paragraph.

It is curious that the exception for minor work found its way into section 67(4)(ba) at all. The reason may be that whoever drafted the paragraph unwittingly followed an inappropriate precedent, namely section 67(4)(e). That paragraph taxes the profits of certain sales of land that follow subdivision of the land. But the provision does not apply where the work involved in the subdivision is merely "work of a minor nature". Whatever justification there may be for the exception in the context of paragraph (e), that reason does not extend to paragraph (ba).

IV ZONING

Section 67(4)(d) assesses profits from the sale of land held for less than ten years where at least twenty per cent of the profit is a consequence of zoning or similar changes. For the most part, this paragraph is precisely drafted and easy to interpret, but there is one difficulty, which relates to cases where zoning changes affect only part of land in question. Suppose, for example, a farm, on a single title, extends both within and outside the boundaries of a borough. Suppose that the zoning of the part of the farm that is within the borough is changed in a manner that increases the value of the land, and the land is sold. Two questions arise in relation to section 67(4)(d).

First, in determining whether more than twenty per cent of the profit results from the zoning change does one consider the profit on the whole of the land, or only the profit on the portion of the land that was affected by the change? Secondly, in taxing the profit, is the whole of the profit to be assessed, or only the part of the profit that relates to the portion of the land that was re-zoned? If the answer to the first question is "the whole of the land" the possibility of the application of section 67(4)(d) is minimised as the zoning profit is spread over and diluted by the profit on the whole of the land. But if the answer to the second question is also "the whole", then paragraph (d) taxes some land that has not in fact been affected by re-zoning.

The answer that is most consistent with the policy of section 67(4)(d) is that it is only the portion of the land that is affected that should be taken into account, for both purposes, though Thorp J suggested by way of obiter dictum in *Swan* v *Commissioner of Inland Revenue* [7] that the opposite is the legally correct answer. In any event, the position should be clarified.

V SUBDIVISION AND DEVELOPMENT

In many senses, paragraph (e) of section 67(4) is the core of section 67. Broadly speaking, it charges tax on profits of land that is subdivided and sold within ten years of acquisition. Paragraph (e) is the core of the section because it was in large part the ineffectiveness of the predecessor to section 65(2)(e) in taxing subdivisional profits that

---

7 (1979) 3 TRNZ 430, 437 - 438.

led Parliament to enact section 67, and secondly because subdivisional profits appear from the reported cases to be the major target of section 67. Considering the significance of paragraph (e) the numbers and gravity of the shortcomings that affect it are noteworthy.

Section 67(4)(f) is related to section 67(4)(e), in that, broadly speaking, it concerns major schemes of subdivision that take place more than ten years after the acquisition of land. Because it relates to cases that are factually similar to section 67(4)(e) section 67(4)(f) shares some of the terminology of the former paragraph. Consequently, some of the shortcomings of section 67(4)(e) are found also in section 67(4)(f).

Considering that the raison d'être of section 67(4)(e) is the relatively simple objective of taxing profits on the disposal of land that has been subdivided, the primary charging words of the paragraph are remarkably elaborate. The paragraph taxes the profits on the sale of land where:

> (i) An undertaking or scheme, whether or not an adventure in the nature of trade or business, involving the development or division into lots of that land has been carried on or carried out, and the Commissioner is satisfied that the development or division work, not being work of a minor nature, has been carried on or carried out by or on behalf of the taxpayer, on or in relation to that land; and
>
> (ii) That undertaking or scheme was commenced within 10 years of the date on which that land was acquired by the taxpayer.

This elaboration of drafting, much of which is arguably otiose, leads to many of the problems with section 67(4)(e).

A Commissioner's Satisfaction

Section 67(4)(e) requires a number of facts to be established before the taxpayer's profits are assessable. The paragraph is so drafted that some of these facts must be determined objectively (subject to the usual burden on the taxpayer) and some must be determined subjectively, by the Commissioner. The reason for treating these facts differently is not apparent. The two sets of facts are:

To be determined objectively, though subject to questions of the burden of proof:

- There was an undertaking or scheme.
- It involved development or division into lots.
- It has been carried on or carried out.
- It was started within ten years of the taxpayer's acquisition of the land.

To be determined to the Commissioner's satisfaction:

- The development or division work was not of a minor nature.
- The work was carried on or carried out by or on behalf of the taxpayer.

- The work was on or in relation to the land.
- All the facts mentioned in the proviso to section 67(4)(e).

Section 67(4)(f) is drafted in a similar manner, distinguishing between facts that are to be determined objectively and facts that are a matter for the Commissioner's satisfaction. There is a similar distinction in section 67(4)(d), though there the facts for subjective determination are said to be a matter of the Commissioner's opinion, rather than satisfaction. The drafting of other parts of section 67 is similarly ambivalent between providing that some facts are to be decided objectively and others are to be determined according to the Commissioner's discretion or satisfaction.

Drafting couched in terms of the Commissioner's discretion or satisfaction sits uneasily in a regime like section 67. Section 67 was enacted to provide a set of objective, easily determinable rules to replace the over-general terms of the predecessor to section 65(2)(e). It is in a sense an admission of failure if Parliament falls back on discretions for the contents of some of those rules, and it is poor public relations if Parliament employs discretions in circumstances such as those in section 67, where they are not needed.

In practice, these drafting distinctions have not yet caused problems in section 67 cases. Indeed, the Act is rife with similar distinctions that seldom cause difficulty. Nevertheless, to put the matter at its lowest, someone coming fresh to section 67 could be forgiven for suspecting that the distinctions are meant to have some significance, and for wasting time in a vain attempt to discover what that significance is. Furthermore, it is probably only a matter of time before counsel in one case or another argues the same thing. If such an argument were adopted by the court and made part of the reasoning for a judgment a whole sub-regime of the jurisprudence of section 67 would develop, to no useful end.

If section 67 is to be renovated there is a good deal to be said for eliminating references to the Commissioner's satisfaction.

B Scheme

The first question is, why introduce the concept of "scheme" into section 67(4)(e) at all? If the object of the paragraph is to tax the profits on sales of land that has been subdivided (or perhaps developed), what policy is advanced by requiring the Commissioner to establish that there has been a scheme? In theory, this requirement limits the operation of paragraph (e), in that subdivision by itself is not enough; there must also be a scheme. In practice, there is little or no limiting effect: it is hard to think of cases where there could be a subdivision of land without a "scheme". After all, before subdividing, the landowner must not only himself plan where the new boundaries are to go, but he must satisfy the local authority that his proposals are permitted. How could one manage that without a "scheme"? Furthermore, Richardson J has observed in *Lowe* v *Commissioner of Inland Revenue* that the terms of section 67(4)(e) "suggest that not a great deal is required by way of activity to constitute a plan or programme of action an "undertaking or scheme" under the paragraph".[8]

No doubt, the concept of "scheme or undertaking" appears in section 67(4)(e) because the paragraph is derived from section 65(2)(e) third limb, which taxes the gains "of any undertaking or scheme entered into or devised for the purpose of making a profit." But section 67(4)(e) taxes the profits of *dispositions*, not the profits of *schemes*. Consequently, a scheme is not logically a necessary ingredient of liability. The draftsman appears to have been influenced by cases on 65(2)(e) or its Australian counterpart, such as *McClelland* v *FCT*,[9] that held that a "scheme" had to be business-like in nature for the section to bite. The simple way around that problem was to abolish the requirement for a scheme altogether, but the draftsman chose instead to water it down by the words "whether or not an adventure in the nature of trade or business".

C "*Carried On or Carried Out*"

The consequences of the retention of the requirement for a scheme go beyond mere convolutions of drafting. One problem is that "scheme" brings with it the possibility of arguments as to whether the scheme has been carried on or carried out. These arguments occurred from time to time in subdivisional cases under the predecessor to section 65(2)(e), with somewhat inconclusive results, perhaps most remarkably in *Duff* v *Commissioner of Inland Revenue*.[10] That case involved a scheme of land subdivision that had been frustrated by compulsory acquisition of the land by the Crown. On the same facts, Barker J held that the scheme had been carried out, not carried on, but Woodhouse P held that it had been carried on, not carried out. Either way the taxpayer lost, but it is hard to see any benefit from importing this sort of argument into section 67.

D *Time of Commencement of Scheme*

The second problem with "scheme" is that section 67(4)(e) does not apply to land sold within ten years of acquisition, but to land land sold after an undertaking or scheme has been commenced within ten years of acquisition. Thus, so long as a plot of land can be said to be a product of a scheme that was started within time there is no theoretical limit to the duration of liability under paragraph (e), something that would probably surprise the Parliament that enacted it.

This open-ended feature of the nominal ten-year period specified by section 67(4)(e) can have curious results. Take, for example, X and Y, both of whom buy land in 1980 and subdivide and sell it in 1992. X started his scheme of subdivision in 1989, and is therefore assessable on the profits of the sales. Y started her scheme in 1991 and escapes the paragraph.

---

8 [1981] 1 NZLR 326, 340.

9 [1971] 1 All ER 969, 120 CLR 487 (PC).

10 (1982) 5 TRNZ 343 (CA).

The significance accorded to the time of commencement of schemes of development or subdivision has meant that from the enactment in 1974 of the predecessor to section 67 attention has been given to working out precisely when it can be said that an undertaking or scheme has commenced, without, in the end, much chance of certainty. In 1974 the Commissioner published in a circular that the commencing date of a scheme of development or subdivision might be the initial preparation of a subdivision plan, but went on to say that this would apply only if steps leading to subdivision and sale followed immediately. An "appreciable delay" before further steps were taken would mean that preparation of a plan would not be treated as the start of a scheme.

Common sense suggests that the Commissioner should be forgiven for this lack of certainty. Considering the infinite variety of possible schemes and of ways in which they might be begun there is no reasonable hope that one could establish firm rules to decide when a subdivisional scheme begins. But the result is that the certainty that was an objective of section 67 has eluded the draftsman in this respect.

In practice, a major result of this aspect of section 67(4)(e) has been litigation over the question of when a scheme should be said to commence, starting with *Cross & Goulding* v *Commissioner of Inland Revenue*,[11] and including cases before the Court of Appeal.

It is probably fair to say that by including the concept of the commencement of a scheme as an ingredient in the charging provisions of section 67 Parliament has allowed a failure of policy to occur. If the policy of the section is to tax the profits of land that is subdivided and sold within ten years of acquisition, then there is every reason for section 67(4) to say just that. If policy calls for a longer period then twelve or fifteen years could be specified. For both ease and fairness of administration it would make sense for section 67(4)(e) to turn on the time of disposal of land and not on the time of the commencement of a scheme of subdivision.

E Development

Section 67(4)(e) and (f) both apply where there has been a scheme "involving the development or division into lots" of land that belongs to the taxpayer. Notwithstanding the presence of the word "development", there seems little doubt that, as originally conceived, section 67(4)(e) and (f) were intended to apply only to land that had been subdivided. The major evidence for this conclusion is that section 67(8) and (9), which furnish exceptions to the paragraphs in respect of residential and rural land, apply only where there has been a subdivision. Secondly, to interpret the paragraphs as applying to cases of development simpliciter leads to absurdity. A single example illustrates both arguments.

Take a farmer who takes up a bush-covered block of land in 1950. She immediately embarks on a development programme that is completed by 1965. She sells in 1990. If section 67(4)(e) applies to development simpliciter then the whole of the profits on the

11 (1985) 8 TRNZ 455, Hardie Boys J.

sale are taxable, with the 1950 acquisition price being the base cost. The reason is that the farmer commenced her scheme of development within ten years of acquiring the land. On the other hand, if the farmer had taken the precaution of dividing the land and selling it as two smaller farms she would qualify for the exemption under section 67(9). These results were not Parliament's intention. Nevertheless, they follow from the decision of Barker J in *Anzamco Ltd (in liq)* v *Commissioner of Inland Revenue*,[12] where the facts were similar to the example, although the taxpayer had held the land in question for thirteen years rather than forty.

The holding in *Anzamco Ltd (in liq)* v *Commissioner of Inland Revenue* was immediately reversed by section 11(3) of the Income Tax Amendment Act 1983, which added a proviso to section 67(4)(e) so that it does not apply where the development in question was:

(a) for any business of the taxpayer carried on on the land; or
(b) for a residence for the taxpayer and members of his family who live with him; or
(c) in order to derive rent or certain other revenues from the land.

This amendment undoes most of the mischief that would otherwise result from the *Anzamco* decision, but fails to remedy a number of cases where, as a consequence of the case, section 67(4) applies in circumstances that are outside the policy of the section. One example is the taxpayer who buys a house and renovates it for his parents or children. Unless the taxpayer charges rent any profit that he makes on the sale of the house when it is no longer needed is taxable to him, assuming that the renovation scheme started within ten years of the acquisition of the house.

Other examples are cases under section 67(4)(f), which is equally vulnerable to the *Anzamco* holding, but which does not benefit from the 1983 amendment to section 67(4)(e). Take, for instance, a taxpayer who buys a block of land that he develops as a shopping centre, renting the shops to tenants. Twenty years later he sells up. Assuming that the development involved significant expenditure on "earthworks, contouring, levelling, drainage, roading, kerbing" and so on, then section 67(4)(f) applies, whether the development occurred immediately the property was purchased, or years later. Similarly, take the taxpayer who buys a dairy farm and grades it smooth for a kiwifruit orchard. On the assumption that the orchardist's activity amounts to "contouring" as that word is used in section 67(4)(f) there is a qualifying scheme of development and the profits are taxable when the orchard is sold.

In these examples the precise operation of section 67(4)(f) is not clear, in that it is only the profits of the development schemes that are taxable under paragraph (f), not the profits on the sale of the land.

Another problem is that there is an argument that paragraph (f) does not apply to the orchardist because it applies only to schemes that involve "... contouring ... or other

12 (1983) 6 TRNZ 135.

work, service or amenity customarily undertaken or provided in major projects involving the development of land for industrial, commercial, or residential purposes".

The effect of the qualifying expression "customarily undertaken ..." is not clear. Probably, it does not apply to "contouring" at all, but only to "other work, service, or amenity". If so, *any* significant contouring is caught, including contouring for agricultural purposes. On the other hand, if the "customarily undertaken" passage does apply to "contouring", does it follow that the "contouring" must be in the context of the "development of land for industrial, commercial, or residential purposes"? Or is it sufficient for there to be contouring of a kind or scale that might occur in such developments?

The better view is that what one might call "contouring simpliciter" is caught by section 67(4)(f), and the work does not have to be in the context of an industrial, commercial, or residential development. The same argument applies to "earthworks ... levelling, drainage ..." and so on, with the result that schemes that involve significant expenditure on any of these activities are caught by section 67(4)(f) whether or not there is any subdivision, and whether the purpose of the development is to sell the land, or to put it into a condition from which income may be earned.

Why was the word "development" inserted into paragraph (f)? It does not seem necessary for taxing purposes. It is hard to think of cases of development without subdivision that are within the policy of section 67 but that would not be caught already by section 65(2)(e), which taxes gains from schemes entered into for the purpose of making a profit. The word was probably inserted into the draft of section 67(4)(e) and (f) on the basis of the unstated drafting principle of never using a single word (division) when you can deploy two (development or division). The section would not suffer from its removal.

F Minor Work

Section 67(4)(e) does not apply if the work involved in developing or dividing the land in question is only "work of a minor nature". This limitation gives rise to two questions: first, what policy is advanced by the restriction? Secondly, what does one mean by "minor nature"?

The policy of the restriction appears to be a desire to adhere to the old concept that there should be something in the nature of a definite, in a sense tangible, scheme before a provision like section 67(4)(e) might operate. Parliament was persuaded that the scheme should not have to amount to an adventure in the nature of trade or business, which was the judicial gloss that had been placed on the previous rule, but it seems that the policy-makers could not bring themselves to the point that any scheme at all, even if involving no more than "minor work", would be sufficient to trigger the paragraph.

In practice, the exclusion from section 67(4)(e) of "minor work" schemes does not appear to have had much effect. The archetype of a subdivisional scheme that involves minor work only is, perhaps, selling off one's domestic tennis court to raise some money, or otherwise dividing a large residential section to permit denser building. But such subdivisions are almost invariably protected by section 67(8), which exempts most subdivisions of the taxpayer's own residential land from the operation of paragraphs (e) and (f). Consequently, the question of whether the scheme in question involves only work of a minor nature is likely to arise rarely, and then only in cases that are not protected by section 67(8).

A subdivision that might be protected is perhaps the sale of a portion of a half-acre industrial site that the taxpayer finds is surplus to the requirements of his business: there is no exemption for business property that applies to section 67(4)(e) or (f). But the fact that such a sale is probably protected by the minor work restriction causes one to ask whether the policy of the restriction is justifiable.

Turning to the second question, from the reported cases it appears that taxpayers have had little success in attempts to bring their subdivisions within the minor work category. An important reason is that in *Wellington* v *Commissioner of Inland Revenue*,[13] Ongley J held that "work" in section 67(4)(e) includes legal and surveying work as well as physical work on the site, and in *Aubrey* v *Commissioner of Inland Revenue*,[14] Tompkins J came to a similar conclusion about "work" as used in section 67(4)(f).

Whether the original draftsman of section 67(4)(e) intended that "work" should include not only physical work on the site but also legal and surveying work is doubtful. Be that as it may, modern planning requirements that apply to almost any subdivision are such that if non-physical work is to be taken into account it is hard to imagine any subdivision that could be completed with no more than minor work.

A second problem with "minor work" is that the meaning of the expression appears to be relative. In *Lowe* v *Commissioner of Inland Revenue* Richardson J said obiter:[15]

> Whether the work is of a minor nature must, it seems, depend on an overall assessment of such matters as the time, effort, and expense involved, measured both in absolute terms and relative to the nature and value of the land on which the work is done.

If Richardson J's words are a correct statement of the law the chances of the work entailed in any subdivision being categorised as "of a minor nature" are further reduced: if the land is not very valuable then even a small amount of work will appear to be relatively not minor. If the land is extensive and valuable, then even if it is relatively easy to subdivide, with not much work, in absolute terms the work will probably not be "of a minor nature". Either way, the taxpayer is caught.

One result of these considerations is that if the minor work limitation were removed it would be unlikely that any cases would come under section 67(4)(e) that are not

13 (1981) 5 TRNZ 151.
14 (1984) 7 TRNZ 58.
15 [1981] 1 NZLR 326, 340.

already caught. Furthermore, paragraph (e) would be internally more consistent: it is hard to see the policy justification for taxing subdivisions in general, but at the same time exempting those that involve only minor work.

G Subdivision

"Division into lots" as used in section 67(4)(e) and (f) appears to refer to the legal process of obtaining two or more separate titles to a piece of land that was formerly wholly on one title.[16] The paragraphs cause tax to be assessed when one or more of these new titles is sold. It follows that the division of a building into a number of unit titles constitutes "division into lots", and when one of the units is sold there is a potential charge to tax, if the other requirements of the section are met.

One can be reasonably confident that the creation of unit titles is a "division into lots" because of the treatment by the courts of the expression "work of a minor nature", discussed above. Since it has been held that legal and surveying work must be taken into account in determining whether work is of a minor nature, it follows that the creation of unit titles can amount to more than work of a minor nature, even though it may entail no physical work on the land at all. This conclusion appears to be consistent with the general policy of section 67, but the position would become clearer if there were no exception in respect of subdivisions that entail only work of a minor nature. In that event, the creation of unit titles would more clearly be within the terms of the section.

It is not clear whether the alternative of subdividing a building by using cross leases, with the tenants owning shares in a land-owning company, also amounts to division into lots. In principle, the tax treatment of the two processes should be the same, but there is an argument that the grant of a lease is not caught by section 67, on the basis that there is no "disposal" of the land. The position is uncertain.

H The "That Land" Argument in Lowe v *Commissioner of Inland Revenue*

Omitting unnecessary words, section 67(4)(e) taxes profits derived from the sale of land where a scheme involving the development or division into lots of *that* land has been carried out in relation to *that* land. Counsel for the taxpayer put to the Court of Appeal in *Lowe* v *Commissioner of Inland Revenue* [17] that when any particular lot of land is sold it cannot be said that *that* land had been divided into lots, because it is in fact only one lot, though perhaps if two contiguous lots are sold in one tax year the whole can be regarded as *that* land and become chargeable under the section.

The Court rejected the argument, primarily on the basis that it leads to absurdity: if the argument is correct it could be that section 67(4)(e) has no effect, or, at most, that the section operates only when contiguous lots are sold in the same year. The argument

16 See *Wellington* v *Commissioner of Inland Revenue* (1981) 5 TRNZ 151, 156, Ongley J.

17 [1981] 1 NZLR 326, 343.

was not advanced again when *Lowe* v *Commissioner of Inland Revenue* went to the Privy Council,[18] and there is not much likelihood that it would have been successful. However, it is always a matter for regret when the literal meaning of a statute has to be rejected because of absurdity. Consequently, if section 67 is to be redrafted there is something to be said for repairing this deficiency. The problem occurs in section 67(4)(f) as well as in section 67(4)(e).

I *Scope of Section 67(4)(f)*

There are several questions of scope that relate to section 67(4)(f). These questions are particularly acute in the context of the "development" limb of the paragraph. First, suppose that there is a development scheme involving earthworks and so on that is clearly within section 67(4)(f). Suppose also that the scheme involves other elements as well, such as building. Does section 67(4)(f) catch all the profits of the scheme, or only the profits that relate to earthworks and so on?

The literal meaning of the paragraph is that all of the profits are caught, though this appears to be contrary to the policy of the section. For example, a taxpayer who buys some land and erects a factory that he rents out or uses himself for a number of years is taxable on the profits of the building and development scheme when eventually he comes to sell the property. Leaving aside the difficult question of how one calculates the profit on a development scheme that was completed some time before sale of the land, and that was undertaken for purposes other than sale, it seems to be outside the policy of the section that capital profits on the construction of the factory should be taxed, though that is the literal result of the terms of the rule. (It is also outside the policy of the section that the earthworks part of the scheme should be taxed, but considering that Parliament expressly excluded developments for capital purposes from section 67(4)(e) by means of the proviso inserted in 1983, while leaving them vulnerable to tax under section 67(4)(f), any argument that such profits are outside paragraph (f) could have little hope of success.)

Section 67(4)(f) applies only to schemes that involve "significant" expenditure on earthworks and so on, or on amenities customarily provided in major developments. The better view is that these words require heavy expenditure in absolute terms. However, Tompkins J held in *Aubrey* v *Commissioner of Inland Revenue*[19] that whether expenditure is "significant" is a relative matter that depends on the size of the subdivision in question, and that expenditure is "significant" if it is not "insignificant". His Honour further held that legal and surveying costs were to be included in "work involving significant expenditure on earthworks" and so on. The effect of these holdings is that the scope of section 67(4)(f) is wider than had been thought and, possibly, wider than was intended by Parliament. If that is so legislative repair is necessary.

---

18 [1983] NZLR 326.

19 (1984) 7 TRNZ 58, 63.

VI ASSOCIATED PERSONS PROBLEMS

Most of the paragraphs of section 67(4) apply whether the taxpayer acquires and disposes of the land in question, or whether an associated person of the taxpayer does so. If they do not apply expressly then they apply by implication, to frustrate a taxpayer who might consider transferring land to an associated person for the latter to make the proposed profit on sale.

The extension of section 67 to transactions by associated persons is necessary if the provision is to retain its teeth. Nevertheless, the associated persons provisions themselves give rise to a number of problems. Two of these are discussed elsewhere in this paper: the use of trusts to avoid section 67, and the question of improvements effected to land by people who are associated persons of builders. Several problems more specific to the associated persons rules are discussed below.

A Associated Persons and Succession

A crucial provision in respect of associated persons is section 67(12), which provides that people who receive transfers of land from others with whom they are associated, and who subsequently dispose of the land, are taxable on any profit that would have been taxable had it been derived by the transferor.

A deficiency in section 67(12) is that it probably does not apply to cases where land passes from one person to an associate by succession on death. Land is *transmitted* in these circumstances, not *transferred*.[20] Consequently, the transaction appears to be outside the terms of section 67(12).

At first sight, the deficiency in section 67 that is mentioned in the last paragraph is remedied by section 91. Section 91 catches transactions where a taxpayer disposes of land for inadequate consideration. Section 91 embraces some land transactions by means of defining trading stock to include land that in the hands of the taxpayer is vulnerable to assessment under section 67. Thus, section 91 catches any taxable profit that a transferor foregoes by disposing of land too cheaply.

The position of the transferee is addressed by section 91(2)(c), which says that: "The person acquiring the trading stock shall, for the purposes of calculating his assessable income, be deemed to have purchased the trading stock at the price which under this section the trading stock is deemed to have realised".

That is, section 91(2)(c) is not a charging provision as far as transferees of trading stock is concerned. It merely provides for the base cost that will apply if the taxpayer is assessed to tax by virtue of a disposal of trading stock, or by virtue of a disposal of some land that is deemed to be trading stock. The relevant charging provision is section

---

20 See further, J Prebble *The Taxation of Property Transactions* (Butterworths, Wellington 1986) §14.6.

67(12), but, as mentioned, section 67(12) applies only where land has been *transferred* to the taxpayer.

B Extension to Associated Persons of the Benefit of Years of Ownership

A principle that informs the operation of the associated persons provisions in section 67 is that when land is transferred between associated persons the transferee should bear tax that would have been borne by the transferor, had the transferor retained the land and disposed of it at the time that the transferee did so. To this end, section 67(13) deems transferees to have held land from the time that it was acquired by their transferors. In this manner, a transferee can get the benefit of the transferor's earlier years of ownership, and thus have an improved chance of establishing the ten years of land holding that removes taxpayers from a number of the charging provisions of section 67.

Section 67(13) reads in significant part:

> For the purposes of paragraphs (b) to (e) of subsection (4) of this section, where any land has been transferred from any person ... to any other person ... and the transferee and the transferor are associated persons, the transferee shall be deemed to have acquired that land on the same date as the transferor acquired that land.

Generally speaking, this form of words will achieve the objective mentioned above. However, a strict reading of section 67(13) leads to the conclusion that it does not help transferees who once were associated with their transferors, but who are no longer associated when they come to dispose of the land in question. The reason is that paragraphs (b) to (e) bite only when someone disposes of land. The benefit of subsection (13) is available only if the disponor and his transferor *are* associated persons at that point. The lacuna in section 67(13) is illustrated by this example:

1970 taxpayer is born.
1983 taxpayer's father, a land dealer, acquires land.
1985 father transfers land to taxpayer, an associated person by virtue of infancy.
1990 taxpayer achieves his majority.
1993 tenth anniversary of father's acquisition of land.
1995 tenth anniversary of transfer of land from father to son.

The taxpayer is vulnerable to section 67(12) in respect of any profit that would have been taxable to his father. By 1990, the taxpayer has accumulated seven years of ownership of the land, two by virtue of his father and five in his own right. By 1993, the two have together owned the land for ten years and, in principle, the taxpayer should be able to sell the land free of any vulnerability to section 67(4)(b)(ii), which is the ten-year rule that applies to dealers and their associated persons. However, in 1993 the taxpayer and his father are no longer associated persons because the taxpayer is no longer an infant. If the taxpayer is not an associated person of his father he cannot date his ownership of the land back to the father's acquisition. Thus, in 1993 the taxpayer has accumulated only eight years of ownership. On the other hand, the taxpayer remains vulnerable to section 67(4)(b)(ii) because he was an associated person of a dealer at the time that he acquired the land.

C Time and Transfers Between Associated Persons

A problem similar to the one identified in the previous section relates to section 67(12), which concerns the transfer of land between associated persons. The objective of section 67(12) is to tax someone who sells land having received it from an associated person if the associated person would have been taxable had he or she kept the land and in due course sold it when the taxpayer did. Section 67(12) applies:

where land *has been* transferred, and
the transferor and the transferee *are* associated persons, and
the transferee *subsequently* sells the land.

The expression "are associated persons" could refer either to the time of the original transfer or to the time of the transferee's eventual disposal of the land; the better view is probably the former. In any event, this is another matter that needs attention in any redraft of section 67.

D Acquisition of Land Before Association with a Vulnerable Party

Section 67(4)(b) applies to a taxpayer who is associated with a dealer at the time that the taxpayer sells the land in question, if the dealer was carrying on a business of land dealing at the time that the taxpayer acquired the land. However, it is not necessary for the taxpayer and the dealer to have been associated at that earlier time. Accordingly, it is possible for a taxpayer to be caught by section 67(4)(b) even though he was not associated with the dealer when the taxpayer acquired the land. Similar results can occur in respect of section 67(4)(ba) and (c). These consequences do not seem to be consistent with the policy of the section.

VII GENERAL AND ACCOUNTING PROBLEMS

A Deductions in Calculating Profit

Section 67 taxes some profits that are essentially revenue in nature, such as the profits that a dealer makes in buying and selling land as part of his dealing business. In such cases the calculation of profit is relatively straightforward. More difficult are cases where the section taxes profits that are capital in nature, for example where a farmer subdivides his farm and sells it off as building sites within ten years of buying the farm.

The general deduction provisions of the Income Tax Act give little guidance as to what items are deductible from gross receipts in calculating profits in a case such as this. General principle suggests that items that would ordinarily be allowable in the context of a capital gains tax should be deducted. Such items include purchase price and costs of acquisition and disposal, but would ordinarily exclude interest, rates, and other holding charges, even though such expenses are ordinarily deductible for income tax purposes.

So far, the lack of rules about the calculation of profits for section 67 purposes has not proved a difficulty, at least if reported cases are representative of cases in general, except in one area. This relates to expenses of a capital nature that are permitted by the Income Tax Act to be deducted in calculating assessable income, as a means of encouraging some economic activity. The principal example is farm development expenses that are deductible under section 129 of the Income Tax Act.

Barker J disallowed a deduction for such expenses in *Anzamco Ltd (in liq)* v *Commissioner of Inland Revenue*[21] on the principle that no expense should be deducted twice. An alternative view is that if Parliament allows the deduction of capital expenses against current revenue in order to encourage a particular form of economic activity, not to allow those expenses to be deducted again when calculating profits for purposes of section 67 is tantamount to taxing back the benefits that Parliament has said the taxpayer should enjoy under section 129. Section 67 throws no light on the correct approach.

B Time for Deduction of Expenses

A matter that often lurks in the background of section 67 cases is the question of timing of deductions for expenditure. The ordinary rule in the New Zealand Income Tax Act is that expenditure that is incurred in gaining assessable income is deductible as it is incurred. This rule is modified in some cases where expenditure laid out in one year relates to benefits that are expected to accrue in later years. However, there is no express statement as to how or whether the ordinary rules apply in section 67 cases.

This absence of reference to section 67 cases is a particular example of a wider problem: the difficulty of applying rules of tax accounting to long term projects in general, particularly long-term land development or building projects.[22]

As far as section 67 cases are concerned two broad approaches are possible. First, one can capitalise all expenses until the land is sold, and then, in calculating profit, deduct all or the appropriate portion of each expense from the price received for land that is sold. An alternative view, explained by Richardson J in *Lowe* v *Commissioner of Inland Revenue*, is that:[23]

> all assets engaged are held on revenue account with the deduction provisions applying in the ordinary way to outlays all of which are on revenue account and that until a sale occurs the land involved stands in the books at cost for tax purposes ....

The second approach could apply only from the point in any particular case where it becomes clear that there will be a section 67 liability. For example, it could hardly be suggested that all landowners should open tax accounting records for the first ten years of their ownership of any land in case they decide to subdivide the land, thus calling section 67(4)(e) into play.

---

21 (Supplementary judgment) (1983) 6 TRNZ 147

22 See, for example, *HW Coyle Ltd* v *Commissioner of Inland Revenue* (1980) 4 TRNZ 1.

23 [1981] 1 NZLR 326, 345.

In practice, the absence of timing rules applicable to section 67 does not seem to cause major problems. Moreover, it would not be easy to work out a detailed regime that would adequately provide for all cases. Accordingly, there is something to be said for letting well enough alone. On the other hand, the lacuna caused by the absence of appropriate rules is curious in a regime that is worked out with the detail of section 67, and there seems every possibility of eventual litigation on the question.[24]

C Matrimonial Transfers

The purpose of section 67(9A) and (9B) is first to enable land to be transferred between spouses for purposes of the Matrimonial Property Act 1976 without triggering a section 67 assessment and secondly (in cases where one of the charging paragraphs of section 67 applies) to ensure that section 67 does bite in the end when the land is eventually transferred out of the ownership of the couple . In effect, section 67(9A) and (9B) treat the ownership of a married couple as if it were the ownership of a single person to determine whether, and if so how, section 67 applies to the land.

Section 67(9A) applies to cases under section 67(4)(a) to (e). Section 67(9B)(a) and (b) apply where the transferor has begun a scheme that will be caught by section 67(4)(f). These paragraphs set out the value at which land will be deemed to pass between spouses, and they operate as they are intended to. Section 67(9B)(c), on the other hand, which applies for purposes of section 67(4)(f) where the transferor spouse has not begun a section 67(4)(f) scheme, is a source of some confusion.

Section 67(4)(f) is not called into play until a taxpayer begins a scheme of development or subdivision that involves significant expenditure on earthworks and so on. Consequently, if a taxpayer who has some land in respect of which she has not begun a section 67(4)(f) scheme transfers the land to her husband there appears to be no need for purposes of section 67 to attribute a value to the land at the time of the transfer. If and when the husband starts a section 67(4)(f) scheme the land will need to be valued at that point, in order to set the base cost for calculating the profits that accrue from the scheme. But the value of the land when it was transferred to the husband is not relevant for this purpose, except possibly, and then only coincidentally, as part of the valuation process.

In spite of the absence of any need for a valuation provision in these cases section 67(9B)(c) is in fact such a provision, and it says that the transferee is to be deemed to have incurred expenditure in the acquisition of the land of an amount equal to the consideration for which that land is, under section 67(9B)(a), deemed to have been disposed of by the transferor. There are several problems with this paragraph, apart from the fact that, as just mentioned, it is not necessary.

24 A similar issue arose recently in respect of purchases and sales of shares. *Commissioner of Inland Revenue* v *Inglis* [1993] 2 NZLR 29; *Commissioner of Inland Revenue* v *Stockwell* [1993] 2 NZLR 40.

First, section 67(9B)(a) is expressed to operate for purposes of section 67(4)(a) to (e), and is therefore not relevant to section 67(4)(f). However, it does not do excessive violence to the statutory language to imply the words "mutatis mutandis", something to which effect was no doubt intended by the draftsman. Secondly, the transfer consideration that is deemed to have passed by section 67(9B)(a) is the cost price of the land to the transferor. That is, in the example given above the husband would be deemed to have acquired the land for the cost that the wife paid when she acquired it.

One possible effect that could be given to this deeming provision is to say that when a transferee spouse carries out a section 67(4)(f) scheme the land must be valued at the original cost to the transferor spouse, and not at its value at the start of the scheme. If this interpretation were adopted section 67(4)(f) would work in the same way as the other paragraphs of section 67(4). That is, the whole of the profits on the land would be taxable, not just the profits on the scheme.

That interpretation is contrary to the policy of section 67(9B) and (9C), which is to relieve matrimonial transfers from tax, not to tax them, or their sequelae, harder than other land transactions are taxed. Nevertheless, if this interpretation is not adopted there is no other obvious role for section 67(9C)(c). One explanation is that the insertion of this paragraph was a mistake in the first place.

D Realisations of Gifts

How is the value of land received by gift to be determined? Take, for example, a property dealer who receives a gift of land and who sells the land within ten years. The dealer is taxable under section 67(4)(b)(ii), unless saved by an exception. What is the base cost to be used in calculating the taxable profit?

In principle, the base cost should not be zero, because that approach would cause the dealer to pay tax not only on his profit but also on the value of the gift. Rather, the base cost should be the market value of the land at the time of receipt of the gift. The difficulty is that it is by no means certain that the Commissioner, or a court, has power to determine cost in this manner.

The problem is that although section 67(9A)(a) empowers the Commissioner to determine the cost of land for the purposes of any of paragraphs (a) to (e) of subsection (4), it specifically refers to "cost price". Thus, section 67(9A)(a) appears not to apply to gifts, where there is no cost at all. One solution might be for section 67(9A) to refer to "acquisition cost" rather than to cost price.

Where the recipient of a gift of land is an associated person of a donor who would be liable to tax under section 67 the problems just described do not occur. The reason is that section 67(12) provides that people who receive transfers of land from others with whom they are associated, and who subsequently dispose of the land, are taxable on any profit that would have been taxable had it been derived by the transferor. Cases of gifts of land between people who are not associated are rare, which is probably why the lacuna that is identified in this section does not appear to cause problems in practice.

VIII AVOIDANCE OF THE SECTION

There are several possible ways to avoid section 67. Most of them require a certain elaboration in planning, and some of them have sequelae that can be inconvenient. It would be surprising if techniques other than those mentioned here do not also exist.

A *Use of Company to Hold Land*

Probably the simplest and most frequently used avoidance technique is for the taxpayer to employ a company to own land instead of owning it himself or herself. When the land is to be sold, disposal can be effected by sale of the shares in the company rather than by sale of the land itself. People who employ companies in this manner will ordinarily ensure that the company that holds the land has no other assets, so that an effective disposal of the land can occur without having first to clear other property out of the company. One reason for the proliferation of companies in New Zealand is that a number of commercial taxpayers have taken the precaution of holding each of the land titles that they own in a different company.

If the acquisition and sale of the shares in a property holding company is part of an overall scheme to make a profit, then the taxpayer will be caught by section 65(2)(e) third limb, as happened in *Bjelke-Peterson* v *FCT*.[25] However, the taxpayer who buys land for capital or private purposes and who holds the land through a company as a precaution against the possibility that he may one day do something that triggers section 67 is not vulnerable to section 65(2)(e).

A disadvantage of employing a company in this manner is that a purchaser of the company's shares takes the tax burden along with the land, which could depress the price received by the vendor. However, the purchaser also takes advantage of the time of ownership of the land by the company, and does not have to start from scratch to establish the ten year period that is significant for many of the provisions in section 67.

A rule to frustrate this avoidance tactic would not be easy to draft. A look-through provision applicable to all sales of shares in companies that own land would be impractical. For example, it would be impractical to look through sales of publicly listed equities in order to determine whether the companies concerned had any land that was chargeable under section 67. A rule that applied to sales of shares in closely held companies only, and then only where land formed more than a certain (rather high) proportion of the company's assets, has some initial attraction. But an important difficulty is that there would need to be concomitant rules to deem the company's acquisition of the land to take place on the date of transfer of shares. Such rules would need to be complex, to take account of the possibility that different fractions of the shares might be sold to different people at different times, which could well mean that a look-through rule is not in the end a practical proposition.

---

25 (1982) 8 AITR 589, Taylor J, HC.

B Shifting Profits by Transfer Pricing

Section 67 is buttressed by section 91, which frustrates attempts to avoid section 67 by selling land at an under-value to someone that the taxpayer wants to benefit. Section 91 deems the sale to have taken place at market value, for tax purposes. However, section 91 does not work where land is sold at an over-value. This omission permits a taxpayer to strip profits out of land before section 67 has a chance to bite. Take this example (which for simplicity makes no allowance for costs of subdivision):

1980 Taxpayer buys a farm for $200,000
1985 The farm is worth $300,000, but if subdivided it would realise another $100,000 profit.
1986 Taxpayer sells the farm to her husband for $400,000
1987 Husband subdivides and sells the farm, realising $400,000 as expected.

The result is that husband is caught by section 67(4)(e), but pays no tax as he has made no profit. Wife pays no tax because, although she has made a profit, she has not subdivided the farm. The same result could be achieved by using a trust to buy and subdivide the farm.

C Exercise of Options

By virtue of section 67(1), "land" includes an option to acquire land. However, by itself this definition does not extend the charging effect of section 67 very far. If the option itself is bought and sold, and if one or more of the paragraphs of section 67(4) applies, then the transaction will be assessable. But the section does not appear to catch cases where an option is acquired at one point, the option is exercised later, and the land is immediately sold.

Suppose that in year one a taxpayer acquires at a price of $10,000 an option to purchase Blackacre for $15,000, which is the value of the land in year one. In year five the land is worth $40,000, and the taxpayer exercises the option with the intention of selling the land immediately, which he does.

The taxpayer's immediate profit in year five is $40,000 minus $15,000, that is $25,000. Deduct $10,000, being the cost of the option, and the taxpayer's net profit is $15,000 between years one and five. Is any part of this sum assessable? The answer is probably no. The exercise of the option is not an assessable transaction because although the option is defined as land there has not been a disposal of the option. Secondly, the taxpayer has not made any profit in year five because in that year all he did was realise the value of the option, which, by year five, was worth $25,000, being the value of the land less the cost of the exercise. This is the reasoning in *AG Healing & Co Ltd* v *Commissioner of Inland Revenue*.[26] The language of section 67 appears to have no impact on the *Healing* case.

---

26 [1964] NZLR 222, Wilson J.

D *Transfer of Options Off Shore*

Another use of options that may not be caught by section 67 is to strip profits out of land that is vulnerable to section 67 by the transfer of options in foreign jurisdictions. It was suggested in J Prebble *The Taxation of Property Transactions*[27] that this strategy can possibly be effective to avoid section 67. That opinion needs to be re-evaluated in the light of subsequent legislation, and it is possible that the opinion was never correct. The matter is canvassed here for completeness, though it appears that there is not in fact a lacuna in section 67 that needs repair.

Where a landowner realises that land that he proposes to sell is vulnerable to section 67 one course is for him to grant an option over the land to a company resident in a tax haven (and not resident in New Zealand), say company A. The price of the option, and the cost of exercising it, is so fixed that the taxpayer does not make a profit on the land. Company A sells the option to company B, with the transaction taking place in the tax haven, and company B exercises the option, thus buying the land from the taxpayer. As mentioned, the taxpayer makes no profit because the cost of exercising the option has been kept low. The profit on the whole transaction is represented by the price of the transfer of the option between company A and company B.

The argument is that in selling the option company A is selling property that is outside New Zealand, even though the option relates to land that is in New Zealand. Accordingly, the profit that company A makes on buying and selling the option is not New Zealand source income, and is therefore not taxable in New Zealand.

For two reasons the opinion that the transactions described do not give rise to New Zealand tax liability should be revisited. First, for the strategy to be worthwhile it is necessary for the New Zealand taxpayer to have access to the profits that are made by company A. Given this requirement, it would be difficult to set up the company in a manner that would not be caught by the New Zealand controlled foreign company legislation in Part XIIC of the Income Tax Act 1976, which came into effect in 1988. Without going into detail, one of the principal functions of Part XIIC is to attribute the income of foreign companies that are resident in tax havens to their New Zealand owners. Accordingly, the profit would be attributed to the New Zealand taxpayer by the controlled foreign company rules.

A second consideration, not mentioned in the 1986 book, is that the sale of the land in response to the exercise of the option would probably be vulnerable to section 91 of the Income Tax Act 1976, which relates to the sale of land at an under value where the land is subject to section 67. Where that happens, section 91 deems the disposal to have taken place at market price. There is no exception for selling land that is subject to an option. Accordingly, is appears that the Commissioner can treat land sold in these circumstances as sold for its full value, and assess the taxpayer on the proceeds.

---

27 Above n 20, §14.11.

E Grants and Sales of Leases

At first sight there might be some question about whether one could avoid section 67 by using leases instead of sales. There are three possible approaches: (a) simply using a lease instead of a sale (b) creating a lease and selling the tenant's interest, and (c) arguing that the creation of a lease does not amount to a subdivision. In each case the answer appears to be that the taxpayer would remain within section 67. For completeness, the reasons are explained here.

Taking first the simple grant of a lease, it is uncertain whether granting a lease is within the expression "sale or disposition of land", as those words are used in the charging paragraphs of section 67(4). However, the grant of a long-term lease as an alternative to selling land is not a viable way of avoiding the section. The reason is that any rent received for the lease is assessable income in any event, as is any premium charged for the creation of the lease, by virtue of section 65(2)(g) of the Act. Accordingly, the grant of a lease would not avoid income tax.

A two-stage process of granting a lease to an intermediary and having the intermediary sell the lease to the true purchaser for a price representing the profit that the original taxpayer would have made had he sold the land outright would be no more successful. The reason is that "land" is defined in section 67(1) to include an estate or interest in land. Accordingly, the sale of the leasehold interest would amount to a sale of land, and the intermediary would ordinarily be taxable as an associated person of the vendor.

A third question is whether the grant of a lease can constitute "division into lots" of land for purposes of section 67(4)(e) or (f). The answer appears to be yes, in that, before granting a long-term lease of part of some land, a landowner would first have to subdivide it, in order to create a title for the lease to operate over.

F Employment of Trustees

One way of working around the associated persons provisions of section 67 is to insert a trust between the person who holds land or who carries on a vulnerable business on one hand and the associated person on the other hand. The draftsman has taken steps to frustrate this kind of tactic. Thus, by virtue of section 67(2)(c), persons associated with each other include any two persons, "one of whom is ... a trustee for [the] spouse or [the] infant child" of the other. Consequently, people cannot avoid tax by putting land in the names of trustees for their spouses any more than they can avoid tax by putting land in the names of their spouses directly. But this statement begs the question of what amounts to a trustee for one's spouse.

The crucial question here is whether a trustee of a discretionary trust, the beneficiaries of which include the spouse of X, is correctly described as a trustee for the spouse of X. (The same question arises mutatis mutandis in respect of infant children.)

Following *DH Cook Ltd* v *IRC (NZ)*,[28] the better view is that the trustee and X are not associated persons. The reason is that although the trustee is a trustee for the spouse he is also a trustee for other people.

If the opinion expressed in the previous paragraph is correct the insertion of a trust can indeed cut the link between people who would otherwise be associated, which offers a number of possibilities for working around section 67.

In principle, there seems nothing to prevent a taxpayer from employing a discretionary trust of which he himself is a beneficiary to act as a trap for profits that would otherwise be caught by section 67. Indeed, strictly speaking the trust could even be a fixed trust for the taxpayer alone, because "any two persons, one of whom is a trustee for the other" is not in the list of parties who are stated to be associated with each other for purposes of section 67.

IX EXCEPTIONS

The charging provisions of section 67 are followed by several subsections that exempt transactions of certain kinds from assessment. One of the notable characteristics of these exempting subsections is that the exemptions vary from one charging provision to another, with the reasons for the variations often not being apparent. The paragraphs of section 67(4) are divided into three groups for purposes of the formulation of the exceptions. That is, the exceptions are formulated in three different ways, one formulation applying to each of the three groups of charging paragraphs. A survey of the exemptions that apply to the groups of paragraphs of section 67(4) illustrates these points.

Paragraphs (a), (b), (ba), and (c) are related to each other in that they tax people because of their personal characteristics, either because of their intention to dispose of land (paragraph (a)), or because of the businesses that they carry on (the other paragraphs). There is no need in respect of paragraphs (a) to (c) for any development or division to be carried out, in contrast with paragraphs (e) and (f), nor for there to have been external economic forces at work by virtue of zoning changes, in contrast with paragraph (d). The exceptions that apply to paragraphs (a), (b), (ba), and (c) are in section 67(5). Broadly speaking, the exemptions apply where what is sold is premises, and the premises have been used for the taxpayer's business or residence.

Paragraphs (e) and (f) relate to development or subdivision. The exemptions to these paragraphs are in section 67(8) and (9). The first relates to residential and the second to agricultural land.

Paragraph (d) relates to profits made from zoning changes. The exceptions to paragraph (d) are in section 67(6), and like the exceptions to paragraphs (e) and (f), they concern land used for residential or agricultural purposes by the taxpayer.

---

28 (1973) 4 ATR 112 Wild CJ, discussed in above n 20 §8.5.

A Dwellinghouse and Occupation

There is an exception to all seven of the charging paragraphs in respect of residential land, but each of the three formulations of the exceptions is different. The first difference is in respect of the question of whether there must be a house on the land in question for it to qualify for the exception.

Subsection 5(b), relating to paragraphs (a) to (c), requires the land to include a dwelling/house that is occupied by the taxpayer, whereas subsection 8, relating to paragraphs (e) and (f), requires only that the land should be occupied as residential land, which presumably includes, say, a holiday section occupied in the meantime by a tent, until the taxpayer builds a house. Presumably, subsection (8) also includes land adjacent to one's dwelling/house, but on another title, that is used as a domestic garden. The justification for the distinction is not clear.

Subsection (6), relating to paragraph (d), neither requires the land to have a dwelling/house on it nor to have been occupied by the taxpayer; his intention to use the land for erecting a dwelling/house for himself and his family, if any, is enough. Like the distinction considered in the previous paragraph, the rationale for this difference is not apparent. It cannot be that Parliament intended to extend relief to people who buy land for a family home but whose intentions are thwarted by a zoning change because the exemption operates only if the purchaser, like the taxpayer, intends to use the land for a family home.

B Area of Land for Residential Exception

Subsection (8) limits the exemption to an original lot of 4,500 square metres. Subsection 5(b) extends to 4,500 square metres (which probably does not include the area on which the dwelling/house stands, if the paragraph is interpreted strictly) "or such larger area as ... is required for the reasonable occupation and enjoyment of the dwelling/house".

In *Parry* v *Commissioner of Inland Revenue,*[29] Tompkins J held that the whole of a ten-acre rural block, much of which was used for hobby farming, qualified for exemption by virtue of this rule, and the reasoning followed by his Honour could well hold good for much larger areas.[30] Subsection (6) has no area limit at all. Again, the policy that justifies these differences is hard to discern.

C Drafting of Residential Exceptions

Some of the drafting in the residential exceptions appears to use more words than are necessary. For example, section 67(5)(b) refers to "a dwelling/house acquired and occupied, or erected and occupied, as the case may be, by the taxpayer". This formulation adds nothing to "a dwelling/house occupied by the taxpayer": the two cases

29 (1984) 7 TRNZ 345, 348.

30 See above n 20, §13.2.

of acquisition and erection are treated in the same manner and they exhaust the possible fact situations in the circumstances, so there is no need to provide for them in the words of the section. Section 67(5)(a), relating to business premises, suffers from the same prolixity.

The second example is "by the taxpayer primarily and principally as a residence for himself and any member of his family living with him". That is, the taxpayer's occupation of the house must qualify under both adverbs, primarily and principally. What does one word add to the other? If anything, what is the policy behind making the taxpayer comply with both?

On the other hand, the balance of the expression, "for himself and any member of his family living with him", is significant. The point is that the exceptions envisage the possibility of more than one use of a dwelling/house, perhaps partly for the taxpayer's family and partly for boarders. The exception requires the taxpayer to weigh the two uses. Is the family home use the primary and principal one? Suppose that the taxpayer occupies his house by himself with three boarders the answer would probably be no. But if the taxpayer, his wife, and two children occupy the house with three boarders and a relation in a granny flat the answer is probably yes.

D Business Land Exemption

Of the three formulations of exceptions, only section 67(5) extends to land used for business purposes. The result is that a land dealer who buys and later sells land that he uses for business purposes escapes section 67, but another businessman who divides and sells his business premises is vulnerable to section 67(4)(e), and a third whose land is re-zoned is similarly subject to section 67(4). Like the residential land exemption, the business premises exemption is presumably justified on the basis that land used for one's business is quintessentially a capital asset for most taxpayers. However, this factor has been influential in the drafting of only the first formulation of the exceptions.

E Exemptions that Require the Sale of Premises

Section 67(5) is unusual in that it requires land to which it applies to include either business premises or a dwelling/house. For example, section 67(5)(b) says that section 67(4)(a), (b), (ba), and (c) shall not apply to "Any land, being a dwelling/house ... together with any land reserved for the occupation and enjoyment of the taxpayer with that dwelling/house ...". Suppose the taxpayer owns such land, and sells a portion of it, keeping the house. He may be liable to tax under section 67(4)(e), having subdivided, but suppose that he is not so liable, either because the subdivisional work was only minor or because he has owned the land for more than ten years.

In this event, the taxpayer will not be able to take advantage of the exception, because the portion of the land that he sells does not include the house, even though the land is within the overall area of dwelling/house and appurtenant land that qualifies for the exception. Similar considerations apply to the sale of land used for business.

A similar problem occurs if the land in question is already on two titles. Suppose the taxpayer buys two adjacent sections, one for his house and one for his tennis court, or suppose that a business taxpayer likewise buys a double lot, one for a factory and the other for a car park and yard. Suppose that either taxpayer sells both of his two titles to a single purchaser. The titles with the house and factory qualify for the exception, but do the other two titles so qualify? The answer is probably no.

The result is that the operation of the exception depends on an artificial distinction: whether or not separate titles have been issued for land that is essentially a single lot. Compare two taxpayers who have houses and gardens on half acres of land. A's land is in one lot; B's land is in two quarter-acre sections, but to anyone looking at the land it appears to be a single plot. A can take advantage of the exception for all of his land, but it is probable that of B's land only the houseproperty qualifies.

F Interpretation of Area Limitations

Continuing from the previous section, a third category of inconsistency occurs when the taxpayer's dwelling/house or business premises, together with their respective appurtenant land, occupy only a portion of a land title. In this event the better view is that the land does not qualify for the exception at all, which puts this taxpayer at a disadvantage compared with the owner of a similar area of land who has his premises on a separate title. An alternative view is that the land qualifies for the exception in part, and any profit on sale should be apportioned over the qualifying and non-qualifying sectors.

One obtains some support for this alternative view from a comparison of the language of section 67(5) and section 67(8). The latter allows an exemption for the profits on the sale of any *lot* that results from the division of "an *area* which before any division by the taxpayer did not exceed 4,500 square metres" (emphasis added). "Lot" no doubt means the land that is on one title. If "area" is used by way of intentional contrast perhaps it means just that: an area of land that is dedicated to one primary use, whether the area coincides with the boundaries of a legally-defined lot or not. If so, the question to be answered in respect of section 67(8) is: did the physical boundaries (whatever they are) of the taxpayer's land exceed 4,500 square metres before subdivision?

If this argument is accepted in respect of section 67(8) it might equally be accepted in respect of section 67(5), which also employs "area" to refer to the maximum extent of land that may qualify for the exemptions allowed by that subsection. As suggested above, the writer believes that this interpretation of section 67 is not correct, and that "area" and "lot" probably both refer to the land that is contained in a single legal title. However, there is something to be said for clarifying the issue.

G Two or More Qualifying Lots

It is a feature of the drafting of the exemptions that, where land must be used for a certain purpose, the taxpayer must occupy or use the land "primarily and principally" for that purpose. That is, there is no requirement for the land in question to be the taxpayer's only, or even primary, residence, farm, or business premises, as the case may be. There is no limit to the number of pieces of land that can qualify for the exceptions, so long as each piece is used "primarily and principally" for one of the favoured purposes. Thus, for example, a taxpayer's principal residence and his holiday cottage could both qualify under section 67(5)(b), section 67(6)(a)(ii), or section 67(8).

There is, however, a less obvious effect of the "primarily and principally" approach that is best illustrated by reference to section 67(8). Suppose that the taxpayer's houseproperty comprises two titles, with his house on one and a garden on the other. Both titles appear to qualify under section 67(8), being occupied primarily and principally as residential land.

As long as the two titles together make up no more than 4,500 square metres in total, this result is consistent with the policy of section 67(8). But one reading of the subsection suggests that the titles should be considered separately. If "an area which before any division by the taxpayer did not exceed 4,500 square metres" refers to the land on a single title, (which, as explained in the previous section of this paper the writer regards as the better view) then it seems that the two titles in the example given above each qualify separately so long as they do not exceed 4,500 square metres individually.

One result may be that a taxpayer who occupies 8,000 square metres as residential land and who plans to subdivide could first divide his land in half, then continue to occupy both halves, and finally divide each 4000 square metre plot into sections of the sizes that he plans to sell. It seems that the whole 8,000 square metres qualifies for the exemption in section 67(8).

H Regular Pattern of Turnover of Houses or Business Premises

One activity that was a target of the section 67 regime when it was first enacted was the practice of buying a residence, living in it while renovating it, selling it at a profit, and repeating the process. Less commonly, one might do the same thing with business premises. If such transactions are treated as being on private or capital account there is no tax. Section 67(4)(a) is the primary weapon of the Commissioner in these circumstances: land that was acquired with the intention of sale is caught by the section. However, the section 67(5) exemption for dwelling/houses or business premises occupied by the taxpayer will cover most such cases.

In an attempt to prevent people who engage in the practice described from taking advantage of the exemption Parliament denied the benefit of the exemption to the taxpayer where "a regular pattern of such transactions has emerged". This attempt does not appear to have been very successful, because the exemption-denying provision has been interpreted rather strictly. First, it must be established that a regular pattern of buying and selling dwelling/houses or business premises *has* emerged. That is, the current sale that the Commissioner is attacking cannot be taken into account to determine whether there is a pattern. (On the other hand, if a pattern has been established it does not seem to avail the taxpayer to claim that the transaction that is now being assessed does not fit into that pattern.) Further, it is probable that notwithstanding that a pattern has emerged, the Commissioner cannot go back and tax the profits of the transactions that make up the pattern.

In *Parry* v *Commissioner of Inland Revenue*,[31] Tompkins J specified in some detail the factors to be taken into account in determining whether there is a pattern: type and location of land, type and method of building, use to which the building is put, and so on. Even when a pattern is established, there remains the question of whether it is regular, which appears to refer to the regularity of the length of time between transactions.

The net result of these considerations is that it is very hard for the Commissioner to call in aid the denial of exemption provision in section 67(5), and, except in cases so clear that the taxpayer is virtually in the business of moving from house to house, it seems that this provision has little effect.

I Farming Land

The second and third formulations contain exemptions for farming land, but the first formulation has none. As a result, if one is a land dealer, a developer, or a builder the profits on any farming land bought and sold within ten years is taxable whether or not any of the businesses mentioned relate to rural land. (This conclusion assumes that the section 67(5)(a) exemption for business premises and land used for the business does not extend to farm buildings and the farm land that surrounds them.)

The second formulation (section 67(6)), relating to profits taxed under paragraph (d), and the third formulation (section 67(9)), relating to paragraphs (e) and (f), are broadly similar in their effects. Such differences as exist reflect differences in the charging provisions, paragraph (d) relating to zoning changes and paragraphs (e) and (f) to development or subdivision and not to any inconsistency of policy between the two exemptions. Nevertheless, some of the particular provisions of section 67(6) and (9) have shortcomings of detail.

J Farming in Partnership

The 1983 Income Tax Amendment Act inserted references to the taxpayer's spouse in both of section 67(6) and section 67(9), so that the subsections now give relief where either the taxpayer, or his spouse, or both the taxpayer and his spouse, use the taxpayer's land for a farming business. These extra words may inadvertently have the effect of narrowing, rather than of broadening, the exemptions. Before they were added there was the question of whether the exemptions applied to land farmed in partnership with one's spouse, or with anyone else. The better view was that the exemptions did so apply. Thus, where two brothers owning adjacent farms operate in partnership, each making his farm available to the partnership business, the better view was that each brother could separately qualify for the exemption.

The addition of the references to spouses puts the question beyond doubt as far as spouses are concerned. Certainly, farming land with one's spouse does not disqualify the a person from taking the benefit of the exemption. But the fact that spouses are

31 (1984) 7 TRNZ 345, 349.

mentioned, and other people are not, suggests that if the taxpayer carries on his farming or agricultural business with anyone else he cannot take advantage of the exception. It seems unlikely that this was Parliament's intention.

K Economic Viability of Subdivided Agricultural Land

Section 67(9) is available to the taxpayer only in respect of a subdivided lot that is "capable of being worked as an economic unit as a farming or agricultural business." The intention of Parliament in drafting this provision was probably to limit the exemption to land that, by itself, is capable of being farmed as an independent economic unit: that is, at a minimum, land that is capable of producing enough income to support one household, or at least one individual. Optimistic farmers might also hope for a return on their capital.

If such was the intention it was not carried into effect. It was suggested in J Prebble *The Taxation of Property Transactions*[32] that "economic unit" as used in section 67 (in contrast to, say, the planning law concept of an "independent economic farm unit") means a unit that can produce a return that is reasonable taking into account the capital, labour, and regular outgoings that are necessarily employed in working it. On this basis, a farm may be an economic unit even if it only takes a day's work a week, and even if it can produce only part of the income needed to support a household. What is required is that the return that does come from the farm should be reasonable when one takes account of the resources that are contributed to it. This opinion was approved by Tompkins J in *Bruhns* v *Commissioner of Inland Revenue*.[33] On appeal the Court of Appeal decided the case on a different basis, and refrained from deciding whether Tompkins J was correct on this point.[34]

L Subsequent Use of Land

In determining the assessability of the profits derived by a taxpayer from a particular transaction it is rare for legislation to stipulate that the intentions of the other party to the transaction are to be taken into account, but both of the formulations of the farming exemption are examples of this rarity. That is, for the exemptions to be available the land must have been acquired by the purchaser "primarily and principally for the purposes of ... the use [on a continuing basis] of that land in any farming or agricultural business". (The bracketed words appear in section 67(6)(b)(i), but not in section 67(9)(c), which itself appears to be a minor inconsistency). There is a similar requirement in respect of the residential exemption in section 67(6), but not in the other two formulations of the residential exemption.

The plight of the taxpayer in having his liability determined by an assessment of someone else's purpose is not as parlous as it initially appears. The general tenor of both formulations of the exemption is that the assessment of the purpose of the other

32 Above n 20, §13.15.
33 (1988) 11 TRNZ 473, 477.
34 (1989) 13 TRNZ 449, 452.

party to the transaction should be done by reference to objectively verifiable facts, such as the price and the terms of the contract of sale of the land. Nevertheless, if one of the objective circumstances that surrounds the sale is that the purchaser immediately converts the land to a used car yard, or starts to bulldoze it flat to build a shopping centre, it will be hard for the taxpayer to discharge the onus on him, even if, up to the sale, everything points to the continuing agricultural or residential use for the land.

One's reaction is that these rules should be improved, but it is not easy to see how that can be achieved without erosion of the policy that drives them. Parliament's objective is no doubt to tax people when they are able to make a significant profit on their land that reflects a change of use, but to make the exemptions available to people who sell land for continuing agricultural or residential purposes. Such a policy is consistent with the overall approach of section 67. This aspect of the drafting of the exemptions justifies examination, but the conclusion could well be to take no action.

M Farming and Residential Exemptions and Section 67(4)(e) and (f)

Section 67(8) and (9), the provisions that furnish exemptions in respect of section 67(4)(e) and (f), operate only if there has been a division of land into lots. This limitation no doubt reflects Parliament's original intention that section 67(4)(e) and (f) similarly would apply only if there has been a division of land. However, as mentioned earlier in this article, Barker J held in *Anzamco Ltd (in liq)* v *Commissioner of Inland Revenue* [35] that paragraph (e) (and, by implication, paragraph (f)) apply even if there has only been development of the land in question, without any subdivision. (Incidentally, this result is a consequence of prolixity in drafting. There was no need for the word "development" to appear in the expression "development or division into lots" in paragraphs (e) and (f).)

Parliament's response to Barker J's decision was not to reverse it but, in effect, impliedly to reinforce it. This reinforcing was achieved by the addition of the proviso to paragraph (e), which carves out from the paragraph's ambit of operation any development or division work that, broadly speaking, is to enhance a capital asset that is to be employed in gaining assessable income. That is, the proviso takes for granted that Barker J was correct in holding that paragraph (e) applies to development simpliciter, and tacitly gives legislative approval to that interpretation.

If such was the intention Parliament should have gone further and amended section 67(8) and (9) so that they too would apply to cases of development simpliciter. It makes no sense for an exemption to operate only if there is a subdivision. As things stand at present, where section 67(4)(e) or (f) embrace a case of development simpliciter that might come under the farming or residential exemption the taxpayer is caught if she sells the land in one block, but qualifies for the exemption if she subdivides, even if she subsequently sells the several lots of the subdivided block to a single buyer all at once.

35 (1983) 6 TRNZ 135.

N Timing Questions

Section 67(8) is available where the land *was occupied* by the taxpayer as residential land before subdivision occurred. In contrast, section 67(9) requires that the land *immediately before* subdivision was used for a farming business. The difference in terminology leads the reader to conclude that a lacuna of non-occupation before subdivision is permissible in respect of the residential exemption, though no such gap is tolerated in farming exemption cases.

One can perhaps find a policy justification for the difference. Sometimes people have to move to another city and take some time before they can sell their house and land (longer, no doubt, if they are subdividing at the same time). Accordingly, a period of vacancy or tenancy between occupation and sale might seem reasonable. By way of contrast, a farm is a business that must be kept going. Even if he wants to move, a farmer will ordinarily remain in occupation until he has found a buyer. But that will not always be the case. Sometimes a farmer will have to retire because of ill health. Farmers in this position would probably employ a manager until the farm was sold, which would presumably comply with the requirement of occupation or use, albeit vicariously. But if the farmer chooses instead to rent the farm to someone else until he can sell it he loses the protection of section 67(9) unless the sale is immediate.

Probably of more frequent practical import is the question of what length of time section 67(8) tolerates between the taxpayer's occupation of the land as a residence, on one hand, and subdivision and sale, on the other hand. The answer appears to be that there is no limit. In *Wellington* v *Commissioner of Inland Revenue*,[36] Ongley J decided that the exemption was available despite a three-year gap between residential occupation and sale and despite the fact that the period of residential occupation had been less than a year. The result seems to be that a relatively short period of residential occupation can immunise land against the bite of section 67(4)(e) and (f) indefinitely.

O "Immediately Before" Division

There is another, more subtle, problem in respect of timing questions that relate to section 67(9). Section 67(9) requires occupation of land for a farming business "immediately before" division. What is meant by "division"? Is it the legal act of obtaining a separate title, or does the word refer to the sale of land in respect of which a separate title has been issued? The answer matters in cases where there is a gap between legal subdivision and sale. Ongley J held in *Wellington* v *Commissioner of Inland Revenue*,[37] that the first is the correct answer, which, with respect, appears to be the better view if the legislation is strictly interpreted. However, this somewhat formalistic view is at odds with the substantive policy of the subsection.

For the purposes of the charging provisions of section 67, the important date is the date on which land is sold. It is only then that the section bites. Accordingly, if an

36 (1981) 5 TRNZ 151.
37 (1981) 5 TRNZ 151, 156.

exempting provision requires that land should be occupied for a farming business "immediately before" something occurs it makes sense for that occurrence to be disposal, not subdivision, which could have occurred many years earlier. The following example was given in J Prebble *The Taxation of Property Transactions*:[38]

1980 Taxpayer buys Blackacre and immediately farms it.
1985 Taxpayer divides off block B, which he leases to someone else.
Taxpayer continues to farm the rest, block A.
1990 Taxpayer sells blocks A and B for farming purposes.

As far as block A is concerned, it does not matter whether "immediately before" division means before the legal act of subdivision or before the sale of the subdivided land. One way or the other, block A qualifies for the exemption. Block B also qualifies, on the basis of Ongley J's judgment, even though the taxpayer has not for five years used block B for a farming business that he carries on. This result appears to be inconsistent with what the draftsman was trying to achieve in formulating the section 67(9) exception. The policy behind the exception would probably be carried into effect more accurately if the requirement were that the taxpayer should have occupied the land for farming purposes immediately before disposal, rather than immediately before division.

38 Above n 20, §13.20.