K A McCLURE

Sections 188A & 129 Income Tax Act Amendment No 2

Research Paper for Taxation LLM
(Laws 531)

Law Faculty

Victoria University of Wellington

Wellington 1983

CONTENTS

Part 1

A. INTRODUCTION

The Income Tax Act, 1976 provides a code for the deductibility of certain expenses or losses in ascertaining a taxpayers assessable income in any income year. The definition of assessable income as found in section 2 [1] refers to "income of any kind which is not exempted from income tax otherwise then by way of a special exemption...".

The assessable income of a taxpayer is charged under section 38 while section 65 deems income received from certain sources to be assessable income. The latter section catches all profits or gains from any business, which of course includes income from farming activities. No deduction is allowed for any expenditure or loss incurred in producing that assessable income except as provided in the Act, which in Section 101 and following, sets out a code for deduction of expenses and losses.

Under section 188 losses incurred by taxpayers may be carried forward and offset against future income. This has been of particular benefit to farmers, especially those commencing farming or carrying out development programmes. Sections 126, 127 and 128 has allowed farmers

1 All references will be to the Income Tax Act 1976

to deduct from their assessable income the cost of developing farm land. The deduction of losses has also enabled those with alternate sources of income to establish tax shelters through a range of avoidance devices. A typical example is the professional person with substantial professional income who purchases land and seeks to deduct farm losses through heavy development expenditure.

In the 1982 budget the Government introduced a number of policy changes. Perhaps one of the more controversial measures was the limitation of losses from certain farming and rental activities. The relevant part of the budget statement is as follows: [2]

> Under the existing income tax legislation, it is possible to deduct certain types of expenditure which are essentially of a capital nature. In the case of enterprises involving substantial interests in land, one of the few assets whose value is at least maintained in real terms, these provisions provide major avenues for tax avoidance. The concessions under which farming and fish farming development expenditure may be deducted, and livestock written down to standard or nil values, are the most obvious sources of this problem. Under inflationary conditions, however, it also has to be

2 "1982 Budget" Government Printer 1982, 26.

recognised that interest largely represents a repayment of capital. The fact that interest is deductible for income tax thus adds to both the incentives and the opportunities for avoiding income tax through the conversion of taxable income into non-taxable capital gain. Accordingly, a number of measures are being taken to restrict these avenues for tax avoidance.

The stated policy changes included:

(a) Where a farm was sold at a profit within ten years of purchase and deductions had been allowed for development expenditure then the profit would be recaptured as assessable income.

(b) Interest deducted in respect of any land used in the production of income would become assessable for tax to the extent of any profit on sale within ten years of acquisition.

(c) Partnerships and syndicates of more than 6 persons engaged in farming, fish farming, horticultural and property owning ventures would be treated as companies for tax purposes.

The budget statements, with the exception of the proposed tax treatment for syndicates, were incorporated in new legislation in the Income Tax Act Amendment No. 2, 1982. The two new sections introduced by the amending act and to be discussed in this paper are sections 188A and 129. Section 188A provides that losses from specified activities, which can be broadly termed those of farming or rental activities, would be subject to a loss limitation of $10,000 per income year per taxpayer.

The second section is section 129 which gave effect to the recapture of development expenditure and interest deductions where land is sold within ten years of purchase.

Section 188A applies to losses incurred in the income year beginning on the 1st April, 1983 or the equivalent accounting year. The section has yet to be applied in practice but it has been viewed with more than passing suspicion by those involved in advising farmers and property speculators. This paper will consider its impact on the farming sector and consider what ways, if any, exist to circumvent its application. The second part of the paper will consider the new section 129 and its treatment of profits on the sale of assets within ten years of acquisition.

B.AN OVERVIEW OF SECTION 188A

1. What is meant by the term 'specified activity':

The starting point in the discussion is to consider the charging sub-section of section 188A which in sub-section 7 provides "Where in any income year any taxpayer incurs a loss in the conduct of any specified activity ...." then the loss offset limit of $10,000 will apply.

The first question to be answered is what is a "specified activity"? This is defined in section 188A(1) by a new definition to the taxing statute which categorises ten separate activities. These may be broadly termed farming activities (other than bloodstock) and property rental activities. It seems clear that the draftsman intended to catch all farming activities. The definition is an exhaustive one commencing as it does with the word 'means'. A consideration of each category will assist in understanding what activities will be caught by the definition.

(a) "The business of animal husbandry, including poultry-keeping, bee-keeping, and the breading of horses (other than bloodstock)" - The word "husbandry" is defined in the Shorter Oxford dictionary as "agriculture, farming". [3] In accordance with the rule of statutory interpretation that

words shall be accorded their common or usual meaning it is submitted that the term "animal husbandry" would include all types of farming activity involving the farming of livestock. The definition then goes on to include bee-keeping, poultry-keeping and the breeding of horses. The use of the word "including" extends rather than restricts the meaning of animal husbandry. From the practical viewpoint, however, little difficulty can be anticipated in categorising a particular farm activity and it is submitted that the definition is all embracing of agricultural activities involving livestock.

However a more difficult problem is encountered in explaining the effect of the words "the business of". These words preface the introduction of nine of the ten categories included in the definition of "specified activity". The word "business" appears many times in the Income Tax Act 1976. It is defined in section 2 in the following terms: "Business includes any profession, trade manufacture or undertaking carried on for pecuniary profit". It is difficult on a first reading to see what, if anything, the use of the word business adds to the definition of "specified activity". However it is proposed to discuss that significance, if any, later in the paper.

3 **Authority for referring to a dictionary to ascertain the meaning of a word is found in many judgments. See Craies Statute Law 7th Edition 1971, 160-61**

(b) "The business of growing trees or plants" - This category raises little interprative difficulty and is broken into two separate parts.

(i) For sale as growing trees or plants.

(ii) For the production of fruit (other than grapes), vegetables, flowers, seeds, or other crops, not being crops (other than flowers) in respect of which the preparation of the land, and the planting and cultivation of the tree or plant, and the harvesting of the crop is accomplished within a period of 12 months.

The twelve month limitation was obviously intended by the draftsman to separate horticulturalists producing annual crops such as the usual market garden produce and the berry fruit growers. How real this distinction is will be questioned in the next category.

(c) "Business of viticulture" - Viticulture is defined in the Shorter Oxford dictionary as the "cultivation of the vine; vine growing". While that description obviously includes grapes it equally applies to kiwi fruit and other crops grown on vines. That interpretation may be a surprise to the Commissioner who has interpreted the two activities, that is grape and kiwi fruit production, as being two separate activities within the definition of specified activity. [4]

(e) "The business of mussel farming"

(f) "The business of scallop farming"

(g) "The business of fresh water fish farming" - All these categories speak for themselves in terms of activities under the Marine Farming Act 1971 and nothing further need be said about them here.

(h) "The deriving, otherwise than in the conduct of a specified activity of the kind referred to in paragraph (a) of this definition, of income from livestock including poultry, bees, and horses (other than bloodstock)" - The definition refers to "the deriving of income" as an activity in itself which it is difficult to reconcile with the making of a loss. Deriving income in its widest sense implies something coming in. If nothing is coming in, that is to say if a taxpayer makes a loss, then there can be no income and hence by definition no specified activity. Be that as it may the language used implies that what is intended to be caught is in fact any income derived from the bailing or leasing of livestock. If that was what the draftsman intended why not say so. Instead the definition

4 See the Inland Revenue "Public Information Bulletin" (Number 120), 100; Example Number 2 where the Commissioner categorises Kiwifruit as a specified activity under para (b)(ii) and Viticulture as a specified activity under para (c).

stands as a last ditch catch all provision which appears logically an impossibility. Section 88 refers to a bailment of livestock which is then deemed to be the holding of an interest in livestock. It is suggested that that deeming provision in itself would be sufficient to bring the bailee of livestock within category number 1 of specified activity. For these reasons it is difficult to envisage what if any activity would be caught by this category of activity but assuming an activity is caught then what losses could be incurred.

(i) The last category refers to "The acquiring or holding of any land with a view to the derivation from the whole or a part thereof of any rents, fines, premiums, or other revenues from any lease, licence, or other agreement relating to that land." Land is separately defined by section 188A(2) and is the same definition used in the new section 129 which will be considered separately in that part of the paper. It is intended to consider section 188A in relation to its impact on the rural sector but several comments may be made in passing. The definition does not apply to all property developers and property development. The use of the words "rents, fines and premiums" all point to some rental activity on the part of the landowner and this is reinforced by the use of the word lease or licence which imply something less than the mere acquiring or holding of land. The language used

implies that the property owner must have formed an intention as evidenced by his actions of renting out the land that he owns or has acquired. The words "other revenues from any lease ..." must be limited by the preceding words so that the effect of the definition is that only any alienation that is a lease or licence or is in the nature of a lease or licence will be caught.

2. Who will be caught be the definition - "conducting a specified activity":

The section speaks of limiting the loss incurred in the conduct of a specified activity to the amount of that loss or $10,000, whichever be the lesser.[5]

The construction of the section is such that it is the taxpayer who must conduct the specified activity before the loss containment provision will apply. To conduct speaks for itself and is defined as "in relation to any taxpayer and to any specified activity" where the taxpayer carries on or engages in or holds an interest in the specified activity either alone or in partnerhsip. There is no associated person test and for example in a family business each member of the family would be able to claim the full amount of the loss up to the maximum of $10,000. An interesting point is that rather than discourage

[5] **Section 188A 7 (a) et seq.**

syndicates, as the 1982 budget had proposed, the legislation would appear to encourage their use as a device to circumvent the loss offset provisions.

The section, it is submitted, is all embracing and will apply to all taxpayers conducting specified activities. In the rural sector that will apply to all farmers, horticulturalists, viticulturalists, and so on. The section then seeks by means of an excluding definition to exempt those whom the legislature did not intend to catch in the loss containment net. In short, and as will appear later, that is the bona fide farmer whose farming activities provided his livelihood as at the 11th October, 1982. That this is so is a curious result and the author ponders the question whether this was a drafting technique or a deliberate intention by parliament.

To escape the net entirely a taxpayer must show that, in respect of any loss incurred in any income year, that he is "... an existing farmer in the conduct of any established activity", section 188A(6).

Who is an existing farmer? The term is defined as "... a taxpayer who conducts any specified activity ... where, in the opinion of the Commissioner, the conduct of the specified activity ... constituted the livelihood of the taxpayer and his sole or principal source of income."

The key to qualify as a existing farmer is that one's livelihood must be provided by the specified activity. Moreover, that livelihood must be the sole or principal source of income.

The word "livelihood" is not defined in the section. It is submitted that livelihood should be accorded its usual and proper meaning. The Shorter Oxford dictionary gives four meanings for livelihood: First - lifetime, manner of life, conduct; Secondly - means of living, maintenance; Thirdly - income revenue, stipend, emoluments; Fourthly - property yielding an income, an estate inheritance, patrimony. The ordinary meaning of livelihood links income with means of living which really doesn't take the matter very far. It does however accord with the use of the word livelihood in the definition. The words "seeking a livelihood" have been construed in relation to a local Court of Requests Act where Lord Tenterden C.J. said in Smith v Hurrell: [6]

> "... I think those words must be contrued with reference to the preceding and subsequent words. The whole stands thus: 'keeping any house, warehouse, shop, shed, stall, stand or seeking a livelihood; or trading or dealing within the same city or liberties'. When I see the words 'seeking a livelihood' so associated with

[6] (1830) 10 B & C 542,545

those other words, it appears to me that the expression must be taken to point to a person who is carrying on some business on his own account..."

What is difficult to reconcile is that section 188A is dealing with the situation where a taxpayer is in a loss situation and in that case it is submitted that the language of the section is strained to speak of a taxpayer as having a livelihood. The concept of livelihood imparts earning a living and therefore receiving an income. If a taxpayer is earning an income and therefore providing his livelihood he cannot be in a loss situation. To sum up, it does no injustice to the wording of the section to say that a taxpayer conducting a specified activity who makes a loss cannot by definition be an existing farmer. It could be argued that the definition does no more than give the Commissioner a discretion, and in exercising that discretion, the yardstick to be applied is whether the taxpayer's livelihood is, or is capable of becoming, the conduct of the specified activity. Even if that is so the Commissioner is directed to consider only the income year in which the taxpayer seeks to deduct a loss and once that point is reached the argument revolves four square to a consideration of livelihood. Moreover the construction of the definition reinforces the views expressed, referring as it does "to sole or principal source of income". It is submitted that these words link the concept of

livelihood with income and add weight to the argument that it is an impossibility to have income and hence livelihood where there is in fact a loss. One possible solution might be that income refers to the taxpayer's pre-tax situation, that is to say the source of his actual living expenses before his "assessable income" or a net figure is arrived at for taxation purposes. Whatever the answer the matter will not be finally resolved until the definition has been interpreted by the courts.

Even assuming a taxpayer in a loss situation can be an existing farmer, that is not the end of the matter, for he must next year show that he conducted an "established activity". This term is defined as "in relation to a taxpayer who is an existing farmer means any specified activity ... that the taxpayer conducted on the 11th October, 1982, where in the opinion of the Commissioner, the conduct of the specified activity ... constituted the livelihood of the taxpayer and his sole or principal source of income". It will be apparent that that definition is couched in the same language as that used to define an existing farmer. The test is whether the taxpayer conducted his farming activities on the 11th October, 1982. For the reasons just discussed it is submitted that any taxpayer who was in a loss situation as at the 11th October, 1982 will not be able to show that he was an existing farmer. The consequence of that would be

that he could not be said to be conducting an established activity and no exemption would be available. If this reasoning is correct then section 188A will work a substantial hardship on many bona fide farmers. It is clear that the Commissioner has not construed the section in this manner nor probably did parliament intend that result. [7]

That the legislation intended to exempt the bona fide existing farmer from the application of the section is made apparent by the concept of "related activity". If an existing farmer commences any other specified activity then that is deemed a related activity. There appears under subsection 188(3) and (4) to be three categories of related activities.

First, any other specified activity conducted by a taxpayer in an income year of the same kind of activity whether or not conducted on the same land. The significance of a related activity is that any losses are aggregated before the $10,000 limit is applied, section 188A(5).

Secondly, where a taxpayer who is an existing farmer commences a new specified activity which is different

[7] **Inland Revenue "Public Information Bulletin" supra n4 at 88,89.**

from his existing activity, then provided the Commissioner is satisfied that the other specified activity is one usually conducted in association with the specified activity of the farmer it will be said to be a related activity. The question of what is a usual and complementary specified activity would appear to be answered by farming practice in the district, and no doubt guidelines will be issued by the Commissioner through district offices.

Thirdly, subsection 4 enables a taxpayer to commence a new specified activity on land held for a period of at least five years. The new specified activity will be deemed a related activity provided the taxpayer is an existing farmer. It would appear the section is aimed at enabling an existing farmer to diversify without being unfairly penalised.

What is not clear is whether development of additional areas of marginal land or increased stocking rates, whether through development of existing land or by better management will be deemed a separate specified activity. If it is then this should be a related activity as long as the existing farmer was conducting an established activity. From the practical viewpoint this will cause farmers and their accountants many problems in keeping and maintaining strict and accurate accounting records. It is interesting to note that the 1982 Amendment introduced a new

section relating to the keeping of business records which is a good deal more onerous than its predecessor. [8]

3. Application of Loss Offset:

Subsection 7 provides that losses incurred in the conduct of a specified activity can be offset against other income in the income year in which that loss is incurred to either the amount of the loss or $10,000 whichever is the lesser.

Subsection 7(b) enables the carry forward of any excess loss to the next income year. Any loss in that income year which is referred to in the section as year two, shall be added to that loss and offset against any assessable income, if any. The carrying forward of losses is subject to the provisions of section 19(3), 188(2)(a) and 188(7) which provide that the losses carried forward are offset in the order in which they are incurred. In the case of companies there is a requirement that the shareholding of the company must be maintained at 40% from the time the loss is incurred through to eventual offset.

Subsection 7(c) limits the loss available in year two against income from other sources to a maximum of $10,000, and

8 **Section 41 1982 Income Tax Act Amendment (No 2)**

Subsection 7(d) establishes the roll over for subsequent years.

Subsection 7(e) applies where there is more than one taxpayer conducting a specified activity. The loss offset is available to each partner in respect of the partnership loss.

Subsections 7(f), (g) & (h) apply to the situation where a taxpayer conducts two or more specified activities and require that losses from any related activities be aggregated and the total loss from these activities to be offset against income from other sources is limited to a maximum of $10,000. The taxpayer can elect in the income year which losses are to be offset against which activity. This would provide some scope for minimising the impact of the loss containment provisions where it is anticipated that one specified activity will trade at a loss in the ensuing income year and one specified activity will not. There is similar provision for the carry forward of losses as is provided in subsection 7(h).

4.Relief:

As has been mentioned subsection 6 purports to exempt the existing farmer from the loss offset limit but

this will only assist the existing farmer conducting an established activity. What is the position of the young farmer who purchases a stepping-stone farm? This is the purchase of a small uneconomic unit designed to gear up the farmer's equity before purchasing a fully economic holding. Under subsection 8 a discretion is given the Commissioner to determine that an amount of loss greater than the $10,000 limit be allowed where the following tests are met. These may be summarised as follows:

(a) The taxpayer is engaged full time in farming which activity amounts to his livelihood or he is in the course of establishing a farm as his livelihood.

(b) The taxpayer derives from his personal exertion income from a business, wages or salary as a consequence of circumstances arising in the course of, and as a result of, his farming activities.

(c) The taxpayer earns income from personal exertion for the purpose of enabling him to meet expenditure essential for himself and his family or for the continuance of his farm operation.

(d) The taxpayer would in the opinion of the Commissioner, suffer hardship if the loss containment provisions were applied.

The statutory exemption requires that all of the above be met before the Commissioner is entitled to exercise

his discretion. Take the example of a shearing contractor who purchases a small uneconomic farm property with the intention of building up his capital and later purchasing an economic farm property. He runs some dry stock on the small unit he has purchased but intends and in fact continues with his shearing business to provide for his family. In that situation the purchase of the unit may well have been budgeted on the ability to claim all expenditure relating to that property in excess of the $10,000 loss containment. It may be argued that he has not been principally and personally engaged in the income year in conducting the specified activity on the property. Moreover there is an argument that the specified activity does not and could not provide his livelihood because by definition he is obliged to obtain off-farm employment. Further it cannot be said that he is in the course of establishing his livelihood in respect of that particular property becuase it is an uneconomic holding. The better view possibly is that he is in the course of establishing his livelihood as a farmer and in the course of time will purchase a wholly economic farm. Further, there is no direction to the Commissioner as to the extent of the loss then to be allowed. The Department's guidelines to date have not set forth any policy directives. [9] Any discretion afforded the Commissioner is subject to the

[9] **Inland Revenue "Public Information Bulletin", supra n4 at 103.**

requirement that that discretion be exercised reasonably. However what is a reasonable balance may yet have to be decided by the Taxation Review Authority or the courts.

C. HOW WILL THE SECTION APPLY TO PRACTICAL SITUATIONS

1. "The Blueberry Grower":

The key to the application of the section is whether a taxpayer is conducting a specified activity. It is curious that all but one of the categories of activity are prefaced with the words "the business of". Do these words import a business test into the definition and if so what is the criteria for being in a business? The answer is best illustrated by an example. Take a person who grows blueberries, clearly a horticultural activity, and prima facie an activity that should be caught by the definition of specified activity. However the blueberry grower claims that section 188A does not apply to him because he is not in the business of growing blueberries and hence any losses he incurs are totally deductible against income from other sources. To answer the blueberry grower's claim it is necessary to ascertain what is meant by "business" and to then consider under what section the blueberry grower can deduct his losses.

The word business appears throughout the Income Tax Act, 1976. It is defined in section 2, and while this has been quoted before it is useful to repeat it here; "Business includes any profession, trade, manufacture or undertaking carried on for pecuniary profit". The use of the word "includes" in a statutory definition usually points to an extending rather than an exhaustive definition. However, this need not necessarily be so. In G v Commissioner of Inland Revenue [10] McCarthy J. had this to say of "business" as it is defined in the 1954 Act and which is identical to the definition in the 1976 Act; [11]

> But on the other hand, a study of the definition itself forces the view that it does not add anything to the common meaning of the word; and so, for myself, I am not prepared to say that the use of the word "business" in s. 88, particularly having in mind the taxing nature of the section and bearing in mind, too, the definition in s. 2, is intended to embrace a profession, trade, manufacture or calling, unless there is shown to exist an intention to carry on the particular activity under consideration for pecuniary profit. But the word "for" does not point to motive. Motive as distinct from intention is generally not the concern of the law. "For" points to intention. I agree with the authors of

10 [1961] NZLR 994
11 ibid 998

> Gunn's Commonwealth Income Tax Law and Practice, 6th ed., that the essential test as to whether a business exists is the intention of the taxpayer as evidenced by his conduct, and that the various tests discussed in the decided cases are merely tests to ascertain the existence of that intention. I think that it conforms with this approach to construe the word "for", when considering a phrase such as "carried on for pecuniary profit" used in relation to an occupation, as importing intention

His Honour cited no authority for the conclusion he reached that 'business' is not an extending definition and therefore did not require an intention to make a profit. However the matter of whether "includes" in a statutory definition necessarily points to an extending definition is not devoid of authority. The Privy Council decision of Dilworth v Commissioner of Stamps [12] was unfortunately not cided to McCarthy J, in G v Commissioner of Inland Revenue. Dilworth's case was concerned with the interpretation of the definition "charitable purposes" in the Charitable Gift Duties Exemption Act 1983. The definition was an inclusive one but Lord Watson delivering the judgment of the Privy Council identified two senses in which "include" could be construed. The second sense Lord Watson spoke of was "means and includes" and in that case

12 [1899] A.C. 994

could amount to an exhaustive explanation for the purposes of the Act. As a consequence it is submitted that the ordinary construction of "business" is such that it should not require as an essential ingredient an intention to make a profit. Despite the strongly persuasive authority of the cases mentioned subsequent New Zealand decisions have come to the contrary conclusion that "business" requires to be undertaken for pecuniary profit. [13]

The first case is Commissioner of Inland Revenue v Watson. [14] The taxpayer conducted the breeding of bloodstock on his farm. The issue was whether the breeding activities for the years 1953 to 1956 amounted to a business or a hobby. The taxpayer sought to deduct expenditure relating to his bloodstock breeding under section 111 of the 1954 Act. The Commissioner disallowed these deductions on the basis that the taxpayer's activities were not a business.

Section 111 was the predecessor of the new section 104. Section 111 of the 1954 Land & Income Tax Act provided

(1) In calculating the assessable income of any person deriving assessable income from one source only,

13 See e.g. J. Prebble - "Intention to Make a Profit and Business in section 65 (2) (9) of the Income Tax Act 1976". (1978) Otago Law Review.

14 [1960] NZLR 259

any expenditure or loss exclusively incurred in the production of the assessable income for any income year may, except as otherwise provided in this Act, be deducted from the total income derived for that year.

(2) In calculating the assessable income of any person deriving assessable income from two or more sources, any expenditure or loss exclusively incurred in the production of assessable income for any income year may, except as otherwise provided in this Act, be deducted from the total income derived by the taxpayer for that year from all such sources as aforesaid.

Prior to 1968 the question of the source of income was critical in deciding whether expenditure or losses were deductible. If a taxpayer had only one source of income then only expenditure relating to that source could be deducted. If there were two or more sources of income then the taxpayers total expenditure or losses were deductible and this was the reason why the taxpayer was trying to establish that he was in business as a breeder.

The case turned on whether the horsebreeding activities of the taxpayer amounted to a business and whether the taxpayer had the intention to make a profit. Henry J. found on the facts "the taxpayer had not proved that he had reached the stage where he had set up in

business for pecuniary profit". [15]

In G v Commissioner of Inland Revenue [16] the court was concerned with establishing what was the assessable income of the taxpayer rather than the deductibility of losses or expenditure. G. was an evangelist attached to the Open Brethren Assemblies. He received substantial gifts and sums of money from the brethren in his capacity as an evangelist. He filed no income tax returns contending that he had earned no assessable income. The Commissioner assessed the taxpayer on an assets accretion test and argued that the taxpayer was conducting a business.

The question of whether the taxpayer was conducting a business within the meaning of section 88 (a) now section 65 was squarely before the court. On the facts the judge found that the taxpayer expected to receive gifts to support he and his family. On that basis the taxpayer was carrying on business for pecuniary profit. There is of course a distinction between motive and intention and as McCarthy J. wryly observed "The true artist rarely paints for monetary reasons only; but even a Picasso intends to sell sufficient of his work to keep body and soul together." [17]

The Court of Appeal considered the definition of

15 Ibid, 264.
16 supra n11
17 supra n11 at 999.

business in Harley v Commissioner of Inland Revenue [18] and approved the approach of McCarthy J. in deciding whether the taxpayers were in the business of farming.. The definition of business must include the intention of the taxpayer to make a pecuniary profit.

In Golightly v Commissioner of Inland Revenue [19] the taxpayer had purchased 62 acres in 1965 on the outskirts of Whangarei. The property needed substantial development and a massive input of capital. The taxpayer sought to deduct his resultant farm losses against his substantial professional income. The Commissioner determined in 1972 that the taxpayer's farm was an uneconomic venture so as not to constitute a business and disallowed the taxpayers farming losses. Whether the taxpayer was entitled to deduct his farm losses fell to be determined on an all or nothing basis because the taxpayer sought to deduct farm development expenditure which was dependant on the taxpayer being engaged in a farming business. Speight J. held that the taxpayer must show in relation to his farming activities an intention of making a profit and in addition that there was a reasonable prospect of making a profit though not necessarily in the year under review.

18 [1971] NZLR. 482
19 [1972] 1 TRNZ 135

A slightly different issue was dealt with in Prosser v Commissioner of Inland Revenue.[20] Mr Prosser, a chartered accountant, had purchased a 40 acre block with the intention of farming part time. His farming activities were not successful and substantial losses were incurred which the objector sought to offset against his accountancy income. The Commissoner disallowed the losses on the basis that the objector was not conducting a business. Quilliam J. held that the term assessable income was defined in the charging section of the Act (then Section 88) and as that section referred to "business" regardless of which limb of Section 111 (now Section 104) that the taxpayer sought to deduct his loss he must show he was carrying on a business. With respect it is difficult to accept that that reasoning is correct and is certainly inconsistent with earlier decided cases.

However, the reasoning of Quilliam J. was applied in Grieve v Commissioner of Inland Revenue[21] where Sinclair J. quoted at length from the judgment in Prossers case. It should be noted that this case was not properly argued as Mr Grieve chose to represent himself. For that reason alone little can be extracted from the judgment.

Case F28[22] provides an interesting discussion of the

20 [1973] ATC 6006
21 [1982)5 NZTC 61,145
22 [1983] 6 NZTC 70-527

deductibility of farm losses. The taxpayer purchased a block of land in 1967 and farmed at a profit until 1974 when production suffered as a result of a drought. The taxpayer was obligated to take secondary employment and his wife continued to farm the land with help from the taxpayer during weekends. From 1974 to 1980 the taxpayer had claimed to deduct losses occurring in his farming activities against wages received from employment off the farm. In the 1980 income year the Commissioner determined that the taxpayer was no longer carrying on a business and was not entitled to deduct farming losses arising from wages paid to the objectors wife and children, depreciation, interest on mortgages secured over the farm and livestock trading at standard values. Both Counsel for the Commissioner and the objector approached the case on the basis that the sole question for decision by the Review Authority was whether the objector was carrying on a business. Counsel for the Commissioner emphasised that the proceedings were not concerned with whether or not the objector should be farming or living on his farm, but whether or not he made a profit from his farm. As a side issue the Commissioner contended that profit in the context of the Act referred to a profit for tax purposes and further that the only type of profit that was of concern was where the taxpayer made a cash profit. The Review Authority had no difficulty in disposing of that point holding that profit is simply the surplus of the receipts of the year over the

expenditure of the year, which excludes any refined sort of meaning such as taxable profit. Of more significance is that neither Counsel for the objector nor the Commissioner advised the Authority the section under which they contended the objectors expenditure should be deducted.

The Review Authority held that to claim deductions for expenditure or losses it was not necessary for the objector to show that he was in business before he was entitled to deduct his farming expenditure. There appeared no reason why such losses should not be capable of deduction under section 104 (a). On the particular facts the Review Authority found that the taxpayer was in business and in accordance with the submissions of counsel that disposed of the case.

It should be noted that Watson's, Harley's, Golightly's and Prosser's cases were all deduction cases. While Watson and Harley turned on the pre 1968 form of section 111 Golightly and Prosser were decided on the post 1968 Amendment to section 111. The point is of significance because of the source of income prior to the 1968 amendment. After 1968 section 111 was amended and is now section 104 which provides;

> In calculating the assessable income of any taxpayer, any expenditure or loss to the extent to which

it -

(a) Is incurred in gaining or producing the assessable income for any income year; or

(b) Is necessarily incurred in carrying on a businessfor the purpose of gaining or producing the assessable income for any income year -

may .... be deducted from the total income derived by the taxpayer in the income year in which the expenditure or loss is incurred.

As Dr Molloy argues section 104 (b) permits the deduction of any expenditure which is "necessarily incurred in carrying on a business for the purpose of producing assessable income". [23] The question for the court should not be whether the taxpayers activities amount to a business but whether assuming the existence of a business is the purpose of that business to produce assessable income. In Prosser's case however Quilliam J. held that the result is the same whether a deduction is claimed under section 111 (1) or (2) now section 104 (a) and (b). Assessable income in section 111 (1) referred back to section 88 (1)(a) which includes "all profits or gains derived from any business and for that reason Quilliam J.

23 **A.P. Molloy "Molloy on Income Tax" (Butterworths 1976)**

held that under either subsection a taxpayer must show he is in business before any deduction is available.

With respect that reasoning appears incorrect. Section 104 (a) speaks of producing assessable income which by inference refers the reader back to section 65 and the various sources of income deemed assessable income. It appears logical that assessable income can be derived from any number of sources and while section 65 (2)(a) refers to a business section 65 (1) refers to income derived from any source whatsoever. To return to the blueberry grower it would appear logical for him to argue that any income he derived was not sourced from a business at all and was therefore deductible under section 104 (a). The difficulty with that argument is that in the words of McCarthy J. In G v Commissioner of Inland Revenue [24] "... motive is distinct from intention". It is inconceivable that the blueberry grower could sustain losses in excess of $10,000 without having his activities classed as a business. In the ordinary course of events his activities would have to have a cash flow to sustain a loss. It is submitted unreal to try and distinguish an absence of intention to make a pecuniary gain where a loss in excess of $10,000 was achieved. [25]

24 supra n11

25 See e.g. B.G. Hansen "Carrying on a business under the Income Tax Act Some Problems of Definition". (1974) Vol 3 Otago Law Review 289

To conclude it seems that to be a business the taxpayer must establish his intention of making a profit. So far as the application of section 188A and the conduct of a specified activity it is submitted there is no real significance attaching to the inclusion of the words 'the business of'. This for the very good reason that a taxpayer's activities are measured objectively and his motives are largely irrelevant. To conduct a specified activity with losses in excess of $10,000 and claim that it is not a business is a practical impossibility.

2.Companies:

A second exception is perceived where an existing farmer conducting an established activity is a company. Take the example of a manufacturing company which also owns and farms a farm property. Probably because of development expenditure and the like, it has made losses which have been offset in the company's accounts against manufacturing income. Does the loss containment provision apply? The answer at first reading would appear, no. The definition of existing farmer applies to any taxpayer including a company. The company has conducted the specified activity, being that of farming, throughout the income year and that conduct constitutes the taxpayers livelihood. The

question is whether it is the company's sole or principal source of income. If the company has income from say its manufacturing activities then it is impossible to say that losses from its farming activities amount to its "sole or principal source of income". In fact if the company's farm operations are in a loss situation then there can be no income at all. In that situation the loss containment provisions of section 188A must apply.

A more interesting question arises under section 191 where in broad terms a company included in a group of companies is entitled to off-set its losses against the group's assessable income. Section 191 (5) provides;

> Subject to section 188A of this Act and subsection (7A) of this section, where subsection (4) of this section applies to any specified group and to any income year, -
>
> (a) The whole or part of any loss ... which has been incurred in that income year by any company included in the specified group in that income year; and
>
> (b) The whole or any part of any loss ... carried forward to that income year pursuant to section 188 of this Act by any company included in the specified group in that income year so far as that loss or part of a loss has not been deducted from or set off against the

assessble income, if any, derived by that company in that income year, -

may, if that company so elects by notice in accordance with subsection (5A) of this section, be deducted from the assessable income ... derived in that income year by such other company or companies included in the specified group as is or are nominated by that company, so far as the balance of that assessable income ... extends, and the amount of the loss or part of a loss of any company so deducted from the assessable income derived by any other company shall not be carried forward in accordance with section 188 of this Act, and any election made in accordance with this subsection shall be irrevocable:

It will be noted that the section is made subject to section 188A. It is submitted that being made subject to that section would require that the loss offset limits of $10,000 would apply before any losses could be brought to account and offset against the group's income. The only exception would be if the company conducting the farming operation could qualify itself as an existing farmer conducting an established activity. In that situation the loss company could bring its total losses forward to be offset against the group's assessable income. In saying that it would be necessary for the

company to meet the shareholding requirements of the section so as to be a specified group within the meaning of section 191 (4).

It may be expected that few companies could be in such a fortunate position but there may well be farming companies which could attach themselves to other activities with the proviso that the various shareholding requirements be met.

Part 2

D.APPLICATION OF SECTION 129

1.Introduction

The farming sector has learned to live with the principal that where land is sold within five years of its acquisition then any deductions for development expenditure under section 126, 127 or 128 will be brought back into the farmer's assessable income in the year of such. The clawback provision was the former section 129 which applied only to farm land and only to development expenditure. [26]

26 **Subsection 2 did include the assignment, expiry, surrender or forfeiture of a lease within the meaning of the Marine Farming Act, 1971.**

The new section 129 extends the period for the clawback of development expenditure from five to ten years. It also brings back any "deduction for interest" during the ten year term. It is important to note that it applies to any land as well as any lease or any interest under a lease within the meaning of the Marine Farming Act, 1971.

2.What transactions are Caught:

The charging provision of section 129(2) which deems as assessable income the amount of the deductions where::

(a) Where any land whether or not together with the improvements thereon, or the lease improvements relating thereto, is sold or otherwise disposed of by a taxpayer within ten years from the date of his acquisition of that land;

The definition of land is the same as that found in section 188A. It includes any estate or interest whether legal or equitable, corporeal or incorporeal, freehold or chattel. The definition is exhaustive and would catch all freehold or leasehold interests in land. A legal estate or interest in land is a proprietory interest where all formalities of law to acquire or confer ownership are vested in the registered proprietor. An equitable interest would apply where the person claiming the interest

may not have acquired the legal estate and a good example of that is the purchaser under an unconditional contract to purchase land. Corporeal property is, as applied to land something tangible and would include possession of it, whereas incorporeal would have the opposite meaning and an example would be a profit a° prende'. A chattel interest in land would include that which is not a freehold interest and a common example is the lease of land.

Time runs from the date of acquisition of the land by the taxpayer. The date of acquisition would be defined by reference to the interest of the person in the land. In a typical situation the relevant date would be determining whether a sale is conditional or unconditional. Once the conditions of a contract are met and the sale is said to be unconditional then the purchaser would have acquired an equitable interest in terms of the definition and time would run. The same would apply to the date of disposition of the property.

The section refers to land as being either "sold or otherwise disposed of". A sale of land speaks for itself. The words "disposed of" it is submitted should be read ejusdem generis with sold, which would catch any transaction where the control or benefit from the land passes from the vendor to a purchaser or assignee.

3. Deduction for Farm Expenditure

The second part of subsection 2 is subparagraph b, which provides that the taxpayer must have claimed as a deduction farm development expenditure which is referred to as expenditure allowed by virtue of sections 126, 127 and 128. There is nothing new in that provision which follows the old section 129. What is new is the definition of"a deduction for interest". This is defined as follows:

In relation to any land to which this section applies means a deduction in respect of any interest which, in the opinion of the Commissioner, was payable on -

(a) Money borrowed (whether secured by way of mortgage over that land or not) and used for the purpose of -

(i) the purchase or other acquisition of that land, together with any improvements thereon, or

(ii) the effecting of any improvements of a capital nature on or in relation to that land; or

(b) Money borrowed and used for the purpose of repayment of any other money borrowed where that other money was used for the purpose of -

(i) any of the purposes referred to in paragraph (a) of this definition:

(ii) the repayment of the money borrowed and used for the aforesaid repayment.

It is clear that the definition applies to interest deducted in respect of capital borrowed for the purpose of acquiring land or improvements. However there is a distinction between land and improvements and capital borrowed for acquiring chattels. There may well be difficulties in apportioning an interest claim where moneys have been raised for a dual purpose. For example money raised for the purchase of land and livestock. The onus will be on the taxpayer to establish on an evidential basis the purpose for which the funds where raised. The same applies to capital for refinancing purposes and it will be essential accurate records be kept by taxpayers and their accountants.

There is an associated person test and any expenditure by that associated person will be brought to account on any sale of land within the ten year period. The test of whether a person is an associated person is found in section 8 and includes

(a) any two companies where the shareholding is substantially the same or are under the control of the same persons

(b)any two persons who are relatives.

Sections 129 (2) (c) and (d) deal with the situation where land is sold or disposed of without improvements and with improvements. Where land is sold without improvements, and the value exceeds the amount of the original purchase price of the land, then the excess is deemed assessable income to the extent only of the total sum of the deductions for farm development expenditure or the deduction for interest. Where land is sold with improvements at an excess over the purchase price plus any expenditure on the improvements, whether by the taxpayer or an associated person, then the excess is deemed assessable income to the extent of the total deductions for farm development expenditure or the deduction for interest.

The first point to realise is that the section will only apply to those transactions where the consideration on the sale exceeded the purchase price.

It is probably not very often that land would

be disposed of without improvements and it is possibly more applicable to sales of a lease or licence under the Marine Farming Act, 1971.

The excess is determined by ascertaining the value of the consideration for the sale. The value of the consideration would obviously be the amount received by the taxpayer. On the sale therefore non-deductible expenditure such as legal fees would be deducted and conversely non-deductible expenditure would be added to the consideration in calculating the purchase price.

Obvious problems would arise in determining the value of land which is disposed of with improvements. More often than not on the purchase of land there is no apportionment made between the value of the land and the value of the improvements. The Commissioner is given a power of apportionment under section 129(7). That section determines that the Commissioner may, where he considers it necessary for the purposes of subsection 2, to determine the price or as the case may be the value of the consideration for the sale of any land. A similar apportionment is preserved where there is a sale of any real or personal property. It may be advisable that taxpayers have a valuation undertaken by a registered valuer prior to completion of a purchase so that some independent evidence is available should any question arise in the

future. It is submitted a more difficult task faces the purchaser who must satisfy the Commissioner of the cost of improvements which he has made to the land. There is a further split up between those improvements for which deduction has not been made and those for which deduction has been made under sections 126 to 128 inclusive.

Finally, the excess as determined is deemed assessable income but only to the extent that that excess does not exceed the total deductions allowed under sections 126 to 128 inclusive, or the total deduction for interest.

4. Depreciable Assets

The section also catches under subsection 3, any depreciable assets which have been sold within ten years of the date of acquisition.

Where any taxpayer has been allowed a deduction pursuant to section 127 or section 128 of this Act in respect of the cost of any asset for which, but for that deduction, a deduction by way of depreciation would have been allowable under this Act, and the asset has been sold or otherwise disposed of by the taxpayer within ten years from the date of his acquisition of that asset, the value of the consideration received for the sale or other disposal of that asset shall be deemed to be assessable income

derived by the taxpayer in the year in which the asset is sold or otherwise disposed of; provided that in no case shall the amount deemed to be assessable income under the subsection exceed the cost price of the asset sold or otherwise disposed of.

The subsection is in similar terms to the old subsection except the ownership period has been extended from five to ten years. There is a break-up between the date of acquisition of the land and the date of acquisition of the chattel. Typical examples include irrigation equipment, frost protection, windmills, and as well as water pumps.

27 There is a similar discretion given the Commissioner to apportion where he deems it necessary the value of the purchase or sale price. Under subsection 4, where the taxpayer is caught by the section he has an election whereby he can spread the amount of the assessible income between the year of sale and any four immediately preceeding income years. The notice of election must be in writing and is irrevocable. Income apportioned in any income year is deemed to have been income derived by the taxpayer in that income year and is assessible for income tax. The spread of tax is calculated in much the same way as the spread of excess income under section 93(3) on the sale of livestock.

27 **Water Pumps have always been included in the Government Valuation of Land by the Valuer General**

E.EXEMPTIONS

These may be dealt with under two separate subheadings.

1.Stepping-stone farmer: Where a farmer sells a farm property which is caught by the clawback provisions of the section and purchases another economic farm property within twelve months then there is a deferrment of the tax payable. Several points arise. The sale of the farm property need not be the first farm owned by the farmer. The section applies;

> (a) Where a taxpayer sells or otherwise disposes of any land - to which this section applies, and that is used by the taxpayer, or by the taxpayer and any other person, primarily and principally in the carrying on of a farming, agricultural, horticultural, viticultural or aquacultural business.

There is no reference to the farm having to be the taxpayer's first farm nor even one on which he earned his livelihood (as that test is applied in section 188A).

The period of twelve months runs from the date of sale of the land the and taxpayer must then purchase an

economic farm property.

Economic farm property is defined in the following terms:

(a) In relation to a taxpayer, means any land which, in the opinion of the Commissioner, after, if he considers it necessary, consultation with the Director General of Agricultural and Fisheries or the General Manager of the Rural Banking and Finance Corporation of New Zealand, or any other person is of such an area and nature that it is capable of being worked by the taxpayer as an economis as a farming agricultural, horticultural, viticultural or aquacultural business, as the case may be.

The test is an evidential one to be determined by the Commissioner having regard to such evidence as he deems necessary. The language of the section requires that the economic farm property be used by the taxpayer or the associated person in carrying on the farming or horticultural or viticultural business as the case may be. Any tax which is assessed under subsection 2 is charged but deferred until the ten years has passed from the date of purchase of the economic property. There is an exception in the proviso to subsection (d) where the economic farm property is disposed or acquired under any

circumstances set out in section 129(9) which will be considered next.

2.General Exemptions

The section does not apply to any profit or gain derived by any person on the sale or other disposition of any land or any asset in certain circumstances.

(a) Land that has been compulsorily acquired under any act by the Crown, Public Authority or Local Authority. Alternatively where the Commissioner is satisfied that the land has been sold in circumstances where if the sale had not been made then the land would have been compulsorily taken in the circumstances just mentioned. It is this second category that would provide some difficulty. The taxpayer would need to satisfy the Commissioner that the land would have been taken which implies more than a mere suggestion or situation obtaining when the Crown might take land.

(b) Sales made by a trustee on the death of any person are exempt where the land was owned by that person at the date of his death.

(c) Applies where there is a forced sale by the spouse of a deceased person where land was held jointly.

The paragraph is intended to exempt transactions to which the circumstances outlined in paragraph (b) have applied and where the spouse of the deceased person carried on a business on that land and the sale arose from circumstances arising primarily, principally and directly from the death of that person.

(d) Exempts sales by spouses of a deceased person where property was inherited by them from a deceased person in respect of paragraph (b) and the sale arose primarily, principally and directly from the death of that person.

(e) The sale or other disposition is made in compliance with any order under any court. Reference is made to section 25 subsection 2 of the Matrimonial Property Act and secondly any other act where the taxpayer satisfies the Commissioner that the sale order of the court was not brought about by any action or inaction on his part. So far as the Matrimonial Property Act is concerned and orders under section 25 this will be discussed under a separate section in the paper.

(f) Exemption is made where any profit or gain has already been taxed under any other provision of the act. This of course would apply where the profit from

the sale of land is taxed under, for example, section 67 dealing with profits or gains from land transactions. However the proviso to the section limits the relief where the profit or gain so derived by the taxpayer is not included in the assessable income derived by that person.

3.Anti-Avoidance

Subsection 10 preserves to the Commissioner the power to reconstruct any arrangement which he construes as relieving any person from liabilility under the section or arranging or conducting the taxpayers affairs so that but for the subsection, any arrangement would operate more favourably than otherwise would be the case. It is clear that the Commissioner will be able to determine the amount of excess assessable to a taxpayer in any situation. This will apply particulary where there are sales of land between related parties and exchange of land deals. In practice how real this will be is difficult to assess. The typical example of a sale of land between related bodies such as a taxpayer and a family trust has always required that the Commissioner be satisfied as to the consideration to establish inter alia whether there is any element of gift and also liability for ad valorem stamp duty. Any transaction involving land would require presentation of the instrument of conveyance to the Stamp Duties Division of the Inland Revenue

Department. As has been observed the Commissioner would require to be satisfied that the consideration appearing in the conveyance was proper and usually would obtain a special valuation from the Valuation Department.

F.APPLICATION OF SECTION

1. The section is all-embracing and will of course apply to the sale of any land not merely agricultural land as has previously been the case. The one major avenue of avoidance will be that the section does not catch transactions involving the transfer of shares in a company. This is because the definition of land applies to the taxpayers interest in land and not rights obtaining to the shareholding of a company.[28] A similar situation has obtained for many years in respect of the Land Settlement Promotion & Land Acquisition Act, 1952 and the ten-man company. The Land Settlement Act of course does not apply to any company having more than ten members, hence the phrase "ten-man company".

2. One of the more interesting ways of avoiding the operation of the section will be under the Matrimonial Property Act, 1976. It will be remembered that any sale or other disposition made pursuant to an order of

28 **Section 82 of the Companies Act 1968 provides "... the shares of any member in a company shall be personal estate... and shall not be of the nature of real estate."**

the court under section 25 subsection 2 of the Matrimonial Property Act, 1976 is exempt from the operation of the section. It is worth considering the provisions of sections 23 and 25 of the Matrimonial Property Act. Section 23 provides when an application can be made to the Court and in sub-section (a) specifies "by either spouse or by the husband and wife jointly". Section 25 provides:

"(1) On an application under section 23 of this Act, the Court may, subject to the provisions of this Act, make:

(a) Such order as it considers just determining the respective shares of each spouse in the matrimonial property or any part thereof, or dividing the matrimonial property or any part thereof between the husband and the wife:

(b) Any other order that it is empowered to make by any proviso of this Act.

(2) Subject to subsection 3 of this section, the Court shall not make an order pursuant to subsection 1 of this section unless it is satisfied that -

(a) The husband and wife are living apart (whether or not they have continued to live in the same residence) or are separated; or

(b) The marriage of the husband and the wife has been dissolved; or

(c) One spouse is, by gross mismanagement or by wilful reckless dissipation of property or earnings, endangering the matrimonial property or seriously diminishing its value; or

(d) The husband or the wife is an undischarged bankrupt.

(3) Notwithstanding anything in subsection 2 of this section the Court may at any time, subject to the provisions of this Act, make such declaration or order relating to the status, ownership, vesting, or possession of any specific property as it considers just."

The wording of subsection 2 commences with the words "subject to subsection 3", which preserves to the court, at any time, the right to make such declaration or order relating to the ownership of any specific property as it considers just.

Prior to the 1983 budget, when new legislation was promised, applications to the court were frequently made by happily married spouses to effect a redistribution

of property. In those circumstances, and where an order of the court was made vesting assets in spouses equally or in unequal shares, substantial savings in gift duty, ad valorem stamp duty and estate duty were made.

These sections have been subject to some judicial interpretation. The first reported decision was Re E.[29] This was an application which came before O'Regan J. under section 23 (a) and section 25(3) of the Matrimonial Property Act. The applicants' sought orders vesting specific property in them equally. The parties were happily married and substantial business assets were involved. In what has become an often quoted paragraph O'Regan J. had this to say.[30]

> In my view there is jurisdiction to make the kind of order sought. Subsection 2 of section 25 (which deals with the more common circumstances in which orders are sought) is expressly made subject to subsection 3 and the latter subsection confers jurisdiction "not withstanding anything in subsection 2. It follows, in my opinion, that at any time applications pursuant to section 23(a) may be made to define the interest of either spouse in property which is subject to the provisions of the Act. On a consideration of such an

29 [1978] NZLR 40
30 Ibid 41

application the court has a discretion whether or not to make such declaration or order but such discretion is circumscribed by the requirement of the subsection that any declaration or order is to be exercised subject to the provisions of this act and as it the court considers just.

O'Regan concluded on the question of jurisdiction he was entitled to hear the application and for support for this view he referred to the long title to the Matrimonial Property Act 1976 which provides "to recognise the equal contribution of husband and wife to the marriage partnership; to provide for a just division of the matrimonial property between the spouses when their marriage ends by separation or divorce, and in certain other circumstances". The Judge viewed other circumstances in which orders may be made as being specifically provided for in subsection 2 and 3 of section 25. In particular happily married spouses could apply to the court for orders in respect of particular property. O'Regan J. went on to make the orders sought after observing that he thought the onus of making out that either spouse had a right to a share of matrimonial property was on them; [31]

> ... [N]onetheless, I think that the applicants have the onus of making out their case .... I do not think that

31 Ibid 43

their own wishes in the matter aid in the determination of the matter. To give them weight could be to encourage the abuse of the provisions of the Act and to make one of its purposes the provision of tax free gifts between spouses.

The judgment of O'Regan J. has been approved in a number of subsequent decisions of the High Court. [32] The significance of applications to the court to effect the tax free gifts between spouses has been circumvented by proposed legislation arising from the 1983 budget. The Government has promised that transfers of matrimonial property by agreement between spouses in accordance with the provisions of the Matrimonial Property Act will be exempt from gift duty provided that as a result the partner to whom the property is transferred gains no more then half of the total matrimonial property.

However it is submitted that applications to the court under sections 23 and 25 Matrimonial Property Act are still appropriate as a means of circumventing section 129. The exemption refers solely to section 25(2) of the Matrimonial Property Act which, as has been observed, is

32 See Harrex v Harrex 3 MPC 77
Ireland v Ireland 3 MPC 89
M v M 3 MPC 114
D v D 4 MPC 50
S v S 5 MPC 138
Stewart v Stewart 5 MPC 150

subject to subsection 3 of section 25. It seems clear that where land particularly farm land has been owned for less than ten years, and application is made to the court for an order redistributing it equally between husband and wife, that the clawback provisions of the Act could not be triggered. The only remaining question is whether subsection 10 can be invoked by the Commissioner to determine any excess as if the court order had not been made. The anti-avoidance subsection refers to any arrangement made between a taxpayer and another person. It would seem to strain that language to suggest that where a specific exemption is invoked that that could be said to be any arrangement thereby enabling the Commissioner to reassess any excess arising on the sale. To so construe would make the exemption in subsection 9 redundant.

To conclude it would seem that the Matrimonial Property Act may still provide an avenue for spouses to redistribute property within the ten year claw-back period without invoking its provisions. Applications to the court and orders effecting a redistribution of property would not take a taxpayer outside the ambit of section 129 but it would, at least, ameliorate the tax consequences where the section's application was unavoidable.

does not solve problem — still need to sell land to avoid pdv. In that event, does Re assoc. pers rule apply?

r
Folder
McC

McClure, K. A
Sections 188A &
129 Income Tax Act
Amendment no 2

456418

Due	Borrower's Name
1/10	ZAIN
22/10	ZAIN
15/6	Billcroft