

QUESTION WE'VE BEEN ASKED

QB 19/14

Income tax – When does the business premises exclusion in s CB 19 apply to preclude land sales from being taxed under ss CB 6 to CB 11?

This Question We've Been Asked (QWBA) explains when the business premises exclusion in s CB 19 of the Income Tax Act 2007 applies to sales of land that would otherwise be subject to tax under any of the land taxing provisions in ss CB 6 to CB 11.

It will be of interest to those selling their business premises, if the sale is potentially taxable under one of those provisions. Primarily this will be taxpayers who bought the premises with the purpose or intention of resale, or taxpayers who are dealers, developers or builders, or associated with someone in one of those businesses.

Key provision

Section CB 19 of the Income Tax Act 2007.

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

Question

When does the business premises exclusion in s CB 19 apply to preclude land sales from being taxed under ss CB 6 to CB 11?

Answer

The business premises exclusion in s CB 19 applies to premises acquired and occupied, or erected and occupied by the landowner mainly to carry on a substantial business. "Business premises" means land, typically including a building, from which a person carries on a business. Subject to certain limitations, the exclusion also applies to land reserved with the business premises for the use of the business.

The s CB 19 business premises exclusion applies only to the extent that the land sold is business premises (together with land reserved with the premises for the use of the business). However, the s CB 19 business premises exclusion is not available if the landowner has engaged in a regular pattern of buying and selling or building and selling business premises.

Explanation

The scope of this QWBA

1. This QWBA focuses on the application of the business premises exclusion in s CB 19. The s CB 19 business premises exclusion is relevant where the sale of land is potentially taxable under:
 - s CB 6 – purpose or intention of resale;
 - ss CB 7 and CB 9 – business of land dealing;
 - ss CB 7 and CB 10 – business of developing or subdividing;
 - ss CB 7 and CB 11 – business of erecting buildings; or
 - s CB 8 – land used for landfill.
2. The s CB 19 business premises exclusion is only relevant to the above land sale rules. There is a separate business premises exclusion for the purposes of the bright-line test. These two business premises exclusions are briefly compared at [30]. The business premises exclusion to the bright-line test is covered in more detail in “QB 19/13: Income tax – When does the business premises exclusion to the bright-line test apply?”.

Meaning of “premises of a business”

3. Under s CB 19, the sale of land that would otherwise be taxed under ss CB 6 to CB 11 will not be taxable if:
 - the land is the “premises of a business” (referred to in this QWBA as “business premises”) (s CB 19(1)(a)); and
 - the landowner acquired and occupied, or erected and occupied, the premises mainly to carry on a substantial business from them (s CB 19(1)(b)).
4. Land that is reserved with business premises for use in the business may also be covered by the s CB 19 business premises exclusion when it is sold with the business premises. This is discussed from [17] to [23].

Business premises requirements (s CB 19(1)(a))

5. “Business premises” is not defined in the Act for the purposes of s CB 19. “Premises” is defined in the *Concise Oxford English Dictionary* (12th ed, Oxford University Press, New York, 2011) as:

A house or building, together with its land and outbuildings, occupied by a business or considered in an official context.
6. At common law, “business premises” can refer to a variety of places from which a business is carried on, whether just buildings, buildings and associated land, or bare land. (*Case Y10* (2007) 23 NZTC 13,097 (TRA); *Thames Water Ltd v Hampstead Homes Ltd* [2003] 1 WLR 198 (CA); *Gardiner v Sevenoaks Rural District Council* [1950] 2 All ER 84 (QB); *C of T v Nightcaps Coal Company (Ltd)* (1909) 29 NZLR 885 (SC)).
7. The Commissioner considers that while business premises will typically include a building, there may be instances where land without a building is business premises. For instance, a quarry may be business premises even if it does not have a building on it, provided that the further requirements of s CB 19 are met. It will be up to the taxpayer to show that the land is business premises.

Requirements of s CB 19(1)(b)

8. Although land may be business premises, this does not mean s CB 19 will necessarily apply. Section CB 19(1)(b) provides that the business premises must be acquired and occupied, or erected and occupied by the landowner mainly to carry on a substantial business from them.

Acquired/erected and occupied mainly to carry on a substantial business

9. The Commissioner considers that to satisfy the requirements of s CB 19(1)(b), the landowner must have first acquired or erected the premises mainly for the purpose of carrying on a substantial business from them. This is tested when the landowner acquired or erected the premises.
10. Section CB 19(1)(b) also requires the landowner to have occupied the business premises mainly to carry on a substantial business. "Occupied" in this context means the landowner (which would include their agent or employee) has a physical presence at the business premises and retains the right to exclude others from the property. A physical presence does not necessarily require a human presence at the premises. The presence of structures or equipment may be sufficient. For example, an automated self-service petrol station would satisfy the "occupation" requirement of s CB 19.
11. Where a landowner leases business premises to another taxpayer, giving them exclusive possession, the landowner does not "occupy" the business premises. Where land is owned by a trust, the trustees must have acquired/erected and occupied the premises mainly to carry on a substantial business of the trust. Occupation by a beneficiary of the trust mainly to carry on their own substantial business will not be sufficient.
12. In the context of s CB 19(1)(b), "mainly" is considered to have the same meaning as "primarily and principally", the phrase used in the earlier equivalents of s CB 19 prior to the rewrite of the Income Tax Act, which was done progressively from 1994.
13. The phrase "primarily and principally", and therefore "mainly" for s CB 19, requires that the relevant purpose (for the premises being acquired/erected) and use (the occupation of the premises) is not only the main purpose or use in the sense of outweighing all the other purposes or uses, singly or collectively, but also the primary purpose or use: *Newman Tours Ltd v CIR* (1989) 11 NZTC 6,027 (HC).
14. Situations may arise where a landowner has occupied premises to carry on a substantial business, for most, but not all of the time they owned the land. This might occur where the landowner vacated the premises prior to sale in order to give vacant possession, or where the landowner temporarily leased the premises to another taxpayer. In these situations, the s CB 19 exclusion may still apply, provided the landowner occupied the premises **mainly** to carry on a substantial business. However, it will be more difficult to argue that premises were acquired/erected and occupied **mainly** to carry on a substantial business the longer premises are:
- occupied by a third party (and not the landowner);
 - occupied by the landowner for a non-business use; or
 - unoccupied.
15. For the s CB 19 exclusion to apply, the premises must have been acquired/erected and occupied "to carry on a ... business". Whether there is a business will be determined using the business test set out in *Grieve v CIR* (1984) 6 NZTC 61,682 (CA). Where a landowner meets the *Grieve* business test, then some or all of the activities of that business must have been "carried on" from the business premises.

“Carrying on” a business from a location requires some or all of the activities of the business to be conducted continuously or habitually from there.

16. Finally, s CB 19(1)(b) requires that the landowner acquired/erected and occupied the premises mainly for carrying on a “substantial” business. Whether a business is “substantial” is a question of fact.

Requirements of s CB 19(3) – what land is included?

17. While s CB 19(1) focuses on land that is business premises, s CB 19(3) provides that non-business premises land may also be covered by the business premises exclusion where it is:
 - land reserved, with the premises, for the use of the business; but
 - limited to an area no greater than what is required for the reasonable occupation of the premises and the carrying on of the business.

“Land reserved, with the premises, for the use of the business”

18. For land to be considered “reserved, with the premises, for the use of the business” under s CB 19(3)(a), the land must:
 - be reserved for the use of the business that is carried on from the premises; and
 - have a sufficiently close physical connection to the business premises land.
19. The Commissioner considers that land reserved “with” business premises will usually be in close proximity to the business premises. Where the reserved land is not part of, or immediately adjoining the business premises land, the closer it is to the business premises, the more likely it is to be considered reserved “**with** the premises”.
20. The words “for use of the business” do not require business activities to be “carried on” from the land. For example, although business activities are unlikely to be carried on from a carpark reserved for staff parking, the carpark would nonetheless be considered reserved “for the use of the business”. The Commissioner considers that the words “for the use of the business”, contemplate both current and future business uses. Land reserved for the future use of a business might be land not currently in use, but kept for the future expansion of the business.

An area no greater than that required for the reasonable occupation of the premises and the carrying on of the business”

21. Even if land meets the requirements of s CB 19(3)(a), s CB 19(3)(b) limits such reserved land to “an area no greater than that required for the reasonable occupation of the business premises and the carrying on of the business”.
22. The amount of reserved land that is required for the reasonable occupation of particular business premises and the carrying on of the relevant business will be a question of fact. The Commissioner acknowledges that while some taxpayers might reserve additional land with their business premises for the future expansion of the business, whether all of the land reserved is “required” for the carrying on of the business will depend on the particular situation.

Must be sold with business premises

23. It is important to note that for reserved land to be covered by the business premises exclusion, it must be sold with the business premises land with which it is reserved.

Apportionment under the s CB 19 business premises exclusion

24. The s CB 19 business premises exclusion applies to the extent that the land sold meets the requirements of the provision. This means it is possible for the s CB 19 business premises exclusion to apply only to part of the land sold, leaving the other part to which the exclusion does not apply still subject to tax. Where a landowner occupies part of a building as their business premises (for example, a single storey of a multi-storey office building), then the s CB 19 business premises exclusion will apply to the proportion of the total sale price of the land that is attributable to that part of the building.
25. The residential land exclusion in s CB 16 applies in the same way. This means situations could arise where some of the land sold by a landowner is eligible for the s CB 19 business premises exclusion, with the balance of the land qualifying for the s CB 16 residential land exclusion. The result in this type of scenario would be that none of the land sold would be taxable.

Section CB 19(2) – the exclusion will not apply if there is a regular pattern

26. Although a land sale might meet the requirements of s CB 19(1) and (3), s CB 19(2) states that the exclusion will not apply if the landowner “has engaged in a regular pattern of acquiring and disposing, or erecting and disposing, of premises for businesses”.
27. Whether a landowner has a regular pattern of acquiring and disposing, or erecting and disposing of business premises will be a question of fact. It will depend on the number of similar transactions and the intervals of time between them. There is no fixed rule about the number of times or how frequently you can buy and sell or build and sell business premises and still use the s CB 19 business premises exclusion. However, generally at least three prior transactions would be needed for there to be a regular pattern – see the discussion in “QB 16/07: Income tax – land sale rules – main home and residential exclusions – regular pattern of acquiring and disposing, or building and disposing”, *Tax Information Bulletin* Vol 28, No 9 (October 2016): 4.
28. QB 16/07 outlines when a person has engaged in a regular pattern of acquiring and disposing, or erecting and disposing of dwellinghouses under s CB 16(3). These same principles apply to determining whether a landowner has engaged in a regular pattern of acquiring and disposing of or erecting and disposing of business premises, which would mean the s CB 19 exclusion is not available.

Business premises land sold at a loss

29. If a landowner sells land covered by the s CB 19 exclusion at a loss, the loss will be capital in nature, so will not reduce the taxpayer’s net income. The sale proceeds are not income (unless a taxing provision without a business premises exclusion applies), so the cost of the land is not deductible.

Comparison between the s CB 19 and s CB 6A business premises exclusions

30. As noted at [2], s CB 19 is not the only business premises exclusion in the land taxing rules. There is a separate business premises exclusion for the purposes of the bright-line test. Although these two exclusions are both described as “business premises exclusions”, they are not the same. “QB 19/13: Income tax – When does the business premises exclusion to the bright-line test apply?” discusses the application of the

s CB 6A business premises exclusion in more detail. In short, the main differences between the s CB 19 business premises exclusion and the bright-line business premises exclusion are as follows:

- Section CB 19 relates to the land taxing provisions from s CB 6 to s CB 11. The bright-line business premises exclusion applies only to s CB 6A (the bright-line test).
- Section CB 19 applies only to land that is the landowner's business premises (and land reserved with the premises for the use of the business). The bright-line business premises exclusion potentially applies where someone else uses the land as business premises.
- Section CB 19 requires the landowner to have **acquired and occupied** or **erected and occupied** the relevant business premises **mainly** to carry on a **substantial** business. For the bright-line business premises exclusion, the premises do not have to be those of the landowner and the business does not have to be substantial.
- Section CB 19 applies **to the extent** that the land sold is business premises (or land reserved with the premises for the use of the business), while the bright-line business premises exclusion applies to all of the land sold, or not at all.
- Section CB 19 does not apply where the landowner has engaged in a regular pattern of buying or building business premises and selling them. The bright-line business premises exclusion does not have such an exception.

Examples

31. The following examples explain how the law applies.

Examples

Example 1 – Business premises of a tenant not the landowner

Mungbean Holdings Ltd (MHL) is associated with Mungbean Developments Ltd (MDL), a company carrying on a business of property developments. MHL is in the business of leasing commercial office space. It owns several office buildings including one that it leases to Edamame Transport Ltd (ETL). ETL has exclusive use of the office building for its transport business.

MHL sells the office building within 10 years of purchase. The sale is taxable under s CB 10(2) because at the time MHL acquired the office building, MHL was associated with MDL, and MDL was carrying on a property development business. Although the office building was business premises, s CB 19 does not apply because MHL did not occupy the office building to carry on its own business of commercial property leasing.

MHL also owns another office building that it occupies exclusively to carry on its commercial leasing activities. If MHL were to sell that building within 10 years of acquiring it, the s CB 19 exclusion would apply, so the land sale proceeds would not be income under s CB 10(2).

Example 2 – Business premises of the landowner

Greenbean Construction Ltd (GCL) is in the business of erecting buildings. It purchases a piece of land and erects a building to use exclusively as its offices and workshop. Three years later, GCL sells the building and purchases a bigger property on the other side of town.

Absent s CB 19, GCL would be liable to pay tax on the sale of the property under s CB 11. However, because GCL erected and occupied the building to carry on a substantial business from, the s CB 19 exclusion applies, so the land sale proceeds are not income under s CB 11.

Example 3 – No building on the land

Redbean Scrapmetal Merchants Ltd (RSML) purchases a piece of bare land for the main purpose of carrying on a substantial business from it. At the time RSML acquired the land, RSML was associated with Favabean Land Dealers Ltd (FLDL), a company carrying on a business of dealing in land. RSML sets up a scrapmetal yard on the land and carries on a substantial business from there. The scrapmetal yard has no buildings on it, just an office in a converted shipping container. The business is very successful. So successful that six years later, RSML needs to move to a bigger site so it sells the land. Absent s CB 19, the sale of the land would be taxable under s CB 9(2). This is because when RSML acquired the land, RSML was associated with FLDL, and the land was sold within 10 years. However, because the requirements of the s CB 19 exclusion are met, the land sale proceeds are not income under s CB 9.

Example 4 – Land with a building that is partly business premises and partly a dwelling

Favabean Beanery Ltd (FBL) purchases a building in the suburbs. At the time FBL purchased the building, it was also associated with Favabean Land Dealers Ltd (FLDL), a company carrying on a business of dealing in land. The building comprises a downstairs retail space and a single-bedroom flat upstairs. The downstairs retail space is twice the size of the upstairs flat.

FBL purchased the property for the main purpose of carrying on its large-scale bean import business. FBL occupies the downstairs retail space and carries on its large-scale bean import business from there. The upstairs flat is rented to Mr Beane under a residential tenancy for the whole time FBL owns the property. After eight years, FBL sells the building for a profit.

Absent s CB 19, the sale of the whole property would be taxable under s CB 9. This is because when FBL acquired the building, FBL was associated with FLDL, which was carrying on a land dealing business, and the land was sold within 10 years. However, because the downstairs retail space was occupied by FBL to carry on its substantial import business, the portion of the sale price attributable to the downstairs retail space is excluded from s CB 9. The portion of the sale price attributable to the upstairs flat is income under s CB 9, because the flat was not business premises, nor reserved with the premises for the use of the business. The cost of the property should be apportioned on the same basis, with only the portion attributable to the upstairs flat being deductible under s DB 23.

Example 5 - Business premises land sold at a loss

Three Bean Salad Ltd (TBSL) purchases a small factory for \$100,000 with the intention of carrying on a bean salad manufacturing business from the factory. At the time of purchase, TBSL was also associated with Favabean Land Dealers Ltd (FLDL), a company carrying on a business of dealing in land.

To TBSL's surprise, the bean salad business takes off and the company soon needs to move to bigger premises. Unfortunately, TBSL bought the factory at the peak of the property market, and when it sells, the value of the factory has dropped to \$80,000. Absent s CB 19, the sale of the property would be taxable under s CB 9(2). This is because when TBSL acquired the land, TBSL was associated with FLDL, and the land was sold within 10 years. However, as TBSL occupied the premises to mainly carry on a substantial business, the s CB 19 exclusion will apply to exclude the sale of the property from being taxable under s CB 9(2). As a consequence, the \$80,000 sale price will not be income to TBSL, and no deduction will be allowed for the \$100,000 purchase price.

Example 6 – Business premises vacated before sale

Stringbean Prefabrication Ltd (SPL) carries on a substantial business of erecting buildings. SPL purchases bare land intending to build apartments on the land, which SPL will then on-sell. However, before building the apartments, SPL decides it needs a new workshop for prefabricating building components. The property it purchased to build the apartments on is in an ideal location for a workshop. Accordingly, instead of building the apartments on the

land, SPL erects a workshop from which to carry on its business. SPL then occupies and operates its business out of the workshop.

If SPL were to sell the workshop, it would be covered by the s CB 19 exclusion. Even though SPL did not acquire the land “mainly for carrying on a substantial business”, it erected business premises for this purpose. SPL then occupied the workshop mainly for carrying on a substantial business.

After three years of occupying the workshop solely to carry on its business, SPL runs into financial difficulties. SPL moves out of the workshop and tries to find a buyer for the property. The workshop is vacant for six months before SPL finally sells it.

SPL is still eligible for the s CB 19 exclusion. This is because even though SPL did not occupy the workshop for the last six months, SPL **erected and occupied** the workshop **mainly** to carry on a substantial business. SPL carried on a substantial business for three years from the premises and so **mainly** occupied them for that purpose, taking into account the whole period of ownership, including the last 6 months when the premises were vacant.

References

Subject references

Business premises exclusion
Land tax

Case references

C of T v Nightcaps Coal Company (Ltd) (1909) 29 NZLR 885 (SC)
Case G76 (1985) 7 NZTC 1,348 (TRA)
Case K21 (1988) 10 NZTC 218 (TRA)
Case M102 (1990) 12 NZTC 2,634 (TRA)
Case Y10 (2007) 23 NZTC 13,097 (TRA)
Gardiner v Sevenoaks Rural District Council [1950] 2 All ER 84 (QB)
Grieve v CIR (1984) 6 NZTC 61,682 (CA)
Newman Tours Ltd v CIR (1989) 11 NZTC 6,027 (HC)
Thames Water Ltd v Hampstead Homes Ltd [2003] 1 WLR 198 (CA)

Legislative references

Income Tax Act 1976, s 67(5)(a)
Income Tax Act 2004
Income Tax Act 2007, ss CB 6A, CB 6–CB 11, CB 16, CB 19, YA 1 (“residential land”)

Other references

Concise Oxford English Dictionary (12th ed, Oxford University Press, New York, 2011).
“QB 16/07: Income tax – land sale rules – main home and residential exclusions – regular pattern of acquiring and disposing, or building and disposing”, *Tax Information Bulletin* Vol 28, No 9 (October 2016): 4.
“QB 19/13: Income tax – When does the business premises exclusion to the bright-line test apply?”.