

IN THE HIGH COURT OF NEW ZEALAND
HAMILTON REGISTRY

M. No. 44/82

18/7

(3)

FMT

W. Z. R.

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BETWEEN LAWRENCE RICHARD PARRY of
Hamilton, Builder

First Objector

A N D JEAN ANNETTE PARRY of
Hamilton, Clerk

Second Objector

A N D THE COMMISSIONER OF INLAND
REVENUE

Commissioner

Hearing: 25th June, 1984.

Counsel: Dr. A. P. Molloy for Objectors.
K. Robinson for Commissioner.

Judgment: 11-7-84

JUDGMENT OF TOMPKINS, J.

THE CASE STATED:

This is a case stated pursuant to s.32 of the Land and Income Tax Act, 1954 ("the Act").

The case stated records that the First and Second Objectors were the directors and shareholders in a private company known as L. R. Parry Ltd. ("the Company"). The Company was incorporated on the 19th June, 1966. During the relevant period it carried on business as a builder.

On the 31st August, 1973, the First Objector purchased a ten acre block of land in Newells Road near Hamilton for \$25,000. In June, 1973, he commenced to erect a house on this land. In June, 1976, he settled the property as a joint family home. In January, 1977, the property was sold for \$108,000.

The Commissioner considered that a profit or gain on the sale of the Newells Road property had been made and was assessable income of the First Objector in terms of s.88AA(1)(c) of the Act. The Commissioner assessed the First Objector's liability for income for the year ended 31st December, 1977, in accordance with this determination. The First Objector objected. The Commissioner allowed that objection to the extent of conceding that the profit on the sale of the Newells Road property should be treated as assessable income of the First and Second Objectors in equal shares. He then issued an amended assessment pursuant to which half the profit was treated as assessable income of each of the Objectors. To that assessment both Objectors objected. Those objections were disallowed by the Commissioner. The questions for the determination of this Court are whether the Commissioner acted correctly in disallowing the Objectors objections to the assessments and, if not, then in what respects should such assessments be amended.

HISTORY:

The First Objector upon leaving school was apprenticed to a builder. He initially worked in the building trade in the Wellington area. In 1961 the Objectors were married. They lived in the Hutt Valley. In 1962 they moved to Hamilton. The First Objector obtained employment in Hamilton with a building firm.

In about October, 1962, the First Objector purchased a section at 28, Fenwick Crescent. On it he built a modest weatherboard three-bedroomed house that was adequate for the needs then of his family.

He sold Fenwick Crescent in June, 1964. He did so to use the capital from the sale of the house to start out as a builder on his own account. At that stage the Objectors had

one child.

In November, 1965, the First Objector bought a section at 25, Hudson Street, Hamilton. On it he built a house in which he and his family lived.

In September, 1969, the First Objector bought a section at 17, Callard Place. He did so because he and the Second Objector considered that by then they had outgrown the Hudson Street property. They decided to build something better. This they did at Callard Place. In January, 1970, Hudson Street was sold and the family moved into Callard Place. The First Objector described this house as a very good house. The Objectors regarded it as their permanent home.

In August, 1973, the First Objector purchased the ten acre block at Newells Road. This was because the First Objector had had a lifelong interest in farming. He therefore decided to buy this ten acre lot in order to indulge in some hobby farming and to provide grazing for horses for his daughter. He regarded this purchase as the beginning of an active interest in farming - an interest that was close to his heart. He said that at the time of purchase there was no thought of erecting on it a house in which the family would live.

The Second Objector has always suffered from asthma. When the family moved to Callard Place the Second Objector's asthma became a good deal worse. It took some three or four years to discover that this was because of an increased dust level resulting from the operation of a pressurised oil-fired ducted central heating system. An occasion occurred when the Second Objector suffered an asthmatic attack, the consequences of which could have been disastrous. After further attempts to resolve this problem, the First and Second Objectors decided that they would have to leave Callard Place. As a consequence they decided

in early 1975 to build a house at Newells Road. This was done. They moved to the Newells Road house in mid 1975.

At that time the property market was depressed. It proved difficult for the Objectors to sell Callard Place. It was not until June, 1976, that it was sold but that sale was only obtained on the basis that the first Objector take as part consideration of the price a house property situated at Ashbury Avenue, Hamilton, at a valuation for the purposes of the Callard Place sale of \$36,500. This he did realising that it was probably an over-value. Ashbury Avenue was immediately put back on the market and finally sold in March, 1977, for \$34,000 - a loss of \$2,500.

For the first three years of his ownership of Newells Road the first Objector used the land for the grazing of his family's horses and dry stock. The first Objector decided to commence an Aberdeen Angus stud. In June, 1976, he purchased seven pedigree heifers. These were then mated with semen from pedigree bulls. Realising that if he were to develop this interest in running a pedigree stud he would need more land, the first Objector initially sought to lease a neighbouring ten acre block, then sought to buy some land of an area of about 40 acres close enough to Newells Road to enable him to operate his stud on both properties. In this he was unsuccessful.

In October, 1976, he entered into an agreement to purchase an 80 acre block of land at Matangi near Hamilton for \$135,000. Although he had originally hoped to finance this purchase without selling Newells Road he was not able to. Consequently that same month the Objectors entered into an agreement to sell Newells Road. In January, 1977, the sale of Newells Road and the purchase of Matangi were completed and the Objectors and their family moved to Matangi. They have lived there ever since.

THE RELEVANT STATUTORY PROVISIONS:

The parties agree that the Act is the relevant statute for the purposes of this case. The Income Tax Act, 1976, takes effect from the 1st April, 1977. The income to which this objection relates is that assessed by the Commissioner for the income tax year ended 31st March, 1977.

In assessing the Objectors for income tax on the profits or gains in the sale of Newells Road, the Commissioner relies on s.88AA(1)(c) of the Act. It provides:-

" (1) For the purposes of paragraph (cc) of sub-section (1) of section 88 of this Act, the assessable income of any taxpayer shall be deemed to include -

(c) All profits or gains derived from the sale or other disposition of any land, where the taxpayer, or any other person where the taxpayer and that other person are associated persons, carried on, at the time the land was acquired, the business of erecting buildings, and the taxpayer or that other person carried out, whether before or after the acquisition of that land by that taxpayer, any improvements, not being improvements of a minor nature, to that land (whether by way of erecting a building or otherwise); and

(i) That land, which was sold or disposed of by the taxpayer, was acquired for the purpose of that business of erecting buildings; or

(ii) That improved land was sold or disposed of by the taxpayer within 10 years after the date on which those improvements were completed; "

The Objectors, in objecting to the Commissioner's assessment, rely on subs.(2) of s.88AA. The relevant parts of this sub-section read:-

" Paragraph (c) of sub-section (1) of this section shall not apply to the sale or disposition of -

(b) Any land, being a dwellinghouse acquired

and occupied, or erected and occupied, as the case may be, by the taxpayer primarily and principally as a residence for himself and any member of his family living with him, together with any land reserved for the occupation and enjoyment of the taxpayer with that dwellinghouse, being an area of land not exceeding 4,500 square metres or such larger area as, in the opinion of the Commissioner, is required for the reasonable occupation and enjoyment of that dwellinghouse, -

unless, in either case, the taxpayer has engaged in the acquisition or erection of such business premises or dwellinghouses, as the case may be, and the subsequent sale or disposition thereof, to the extent that, in the opinion of the Commissioner, a regular pattern of such transactions has emerged and, in any case where the Commissioner is of that opinion, any profits or gains arising from any such transaction or transactions shall be deemed to be profits or gains to which paragraph (a) or paragraph (b) or paragraph (c), as the case may be, of subsection (1) of this section applies. "

THE OBJECTORS' CONTENTIONS:

The Objectors admit -

- (1) They made a profit derived from the sale of Newells Road.
- (2) By virtue of s.88AA(10) the company and each of the Objectors are associated persons.
- (3) At the date Newells Road was acquired in August, 1973, the company carried on the business of erecting buildings.
- (4) The Objectors carried out after the acquisition of Newells Road improvements not being improvements of a minor nature by way of erecting a building.
- (5) Newells Road with the building being improved land was sold by the Objectors within ten years after the date on which the improvements were completed.

The Objectors claimed that in calculating the profit on the sale of Newells Road the Commissioner erred in denying the Objectors deductions in respect of rates and interest incurred in respect of Newells Road. But primarily the Objectors claimed that the circumstances brought them within the exemption in subs.(2).

THE CLAIM TO EXEMPTION:

This involves consideration of first, the applicability of paragraph (b) and, secondly, if that paragraph applies, whether the exemption is lost through the operation of the concluding portion of subs.(2) - what may be termed the exception to the exemption.

It was accepted by the Commissioner that the land at Newells Road had erected on it a dwellinghouse that had been erected and occupied by the Objectors primarily and principally as a residence for them and their family.

But an issue still arose because Newells Road was, as I have stated, a ten acre lot, or, to be more precise, an area of land containing 4.1126 hectares (slightly over 10 acres). It was therefore larger than the area of 4,500 square metres (about 1.125 acres) referred to in para. (b).

The Objectors contended that the larger area was required for the reasonable occupation and enjoyment of the dwellinghouse. The evidence established that at the time Newells Road was purchased, and during the whole of the period that it was owned by the Objectors, the minimum subdivision permitted in the Waikato County (in the district of which Newells Road is) was 50 acres. Thus it would not have been possible to erect and occupy the dwellinghouse on the land without owning the whole of the block. Further subdivision to reduce the area about the house to 4,500 square metres or less would not have been permitted. Thus it seems to me to follow that the larger area was required to enable the Objectors and their family to occupy and enjoy the dwellinghouse.

Also relevant is the use to which the larger area is put. The evidence did not describe this in detail. Until June, 1976, it was used for grazing the family's horses and dry

stock. This is the type of hobby farming use common on ten acre blocks in the district - a use that is part of the enjoyment of a dwellinghouse in a rural area. In June, 1976, the first Objector commenced his pedigree operation. Even if that not be regarded as incidental to the enjoyment of the dwellinghouse, it commenced only six months before the sale of Newells Road. The Commissioner did not submit that if this were a change in the use it was relevant to the application of paragraph (b).

In the respects that I have described I conclude that the larger area was required for the reasonable occupation and enjoyment of the dwellinghouse.

I now consider the exception to the exemption. This requires the Court to decide whether the Objectors have engaged in the acquisition or erection of dwellinghouses and their subsequent sale to the extent that a regular pattern of such transactions has emerged.

I commence with the phrase "a regular pattern of such transactions". In my view, in the context in which it is used, "pattern" denotes a similarity or likeness in the transactions. The transactions relied on must bear a similarity or likeness each to the others.

In the same context the word "regular" is used in the sense of recurring at uniform or near uniform intervals. There must therefore be a sufficient degree of uniformity or at least consistency of occurrence.

So in considering whether there has been a regular pattern of erecting dwellinghouses and subsequent sale, the Court must consider each transaction to assess the degree of similarity each to the others. This involves considering factors such as the type and location of the sections, the type of the dwelling-

houses, the method of erection, the use to which the dwellinghouses were put and, in particular, whether occupied by the Objector, and any other characteristics of the transaction that may be relevant in assessing similarity. The Court must also consider the number of transactions and the intervals of time between each, thereby assessing the degree of uniformity or consistency of occurrence. In the end it will have to determine as a matter of fact and degree whether the events that occurred demonstrate a regular pattern of such transactions.

On this approach it does not seem to me to be relevant to consider the reason or purpose for each transaction. It is the similarity of the transactions that is significant, not any similarity in the reason, purpose or intention for entering into each transaction.

The only decided case of which I am aware on the exemption in subs.(2) is Case 9 (1977) N.Z.I.T.C. 60,058, where the Taxation Review Authority adopted, at p.60,074, an interpretation similar to that to which I have referred.

Mr. Robinson, for the Commissioner, in submitting that a regular pattern had emerged, relied upon the Fenwick Crescent, Hudson Street, Callard Place and Ashbury Avenue transactions. He did not contend that there should be included for consideration the Newells Road transaction - that now sought to be taxed. I consider he was correct in adopting this approach. I read the exception to the exemption in the context of the whole of subs.(2) as requiring the taxpayer to have engaged in transactions of the kind described in the exception independently of and prior to the transaction sought to be taxed. It is the prior emergence of a regular pattern of such transactions that renders taxable the profit or gain from the transaction in issue. This seems to follow from the statutory objective of the subsection as a whole and also from the use of the words "has engaged" in the

exemption.

In considering the pattern of the transactions I disregard the purchase and sale of Ashbury Avenue. I am satisfied that the Objectors bought and sold this property only because it was necessary to do so in order to effect an acceptable sale of Callard Place. In that respect it was distinctly dissimilar from the remaining three transactions relied upon by the Commissioner.

There are certainly similarities in those three transactions, i.e. Fenwick Crescent, Hudson Street and Callard Place. In each case -

- (1) The First Objector had purchased an empty section.
- (2) The section was a suburban residential section located in the Hillcrest area.
- (3) He had himself, that is, partly by his own labour and partly by labour of employees of the company, erected houses on each section.
- (4) They were each dwellinghouses. It appears they differed in size. The evidence did not go into the detail by describing their size, style, etc. except that Callard Place was a superior house to the other two.
- (5) The First Objector and his family lived in the houses so erected.
- (6) The house was sold as the family moved to the next one.

There is, therefore, in my view a sufficient degree of similarity between these three transactions to justify a finding that there was a pattern.

But I do not consider that the transactions could properly be described as regular. To illustrate this, I set out the three transactions in tabular form:-

<u>Description</u>	<u>Date of Purchase</u>	<u>Date of Sale</u>
28 Fenwick Crescent	October 1962	June 1964
25 Hudson Street	November 1965	January 1970
17 Callard Place	September 1969	June 1976

This shows that the Objectors owned Fenwick Crescent for one year eight months. Then for one year and five months they did not own any property. They owned Hudson Street for four years and two months. And Callard Place for six years and nine months. The total period encompassed by the three transactions is thirteen years eight months.

It is my conclusion that, having regard to the relatively few transactions and the lengthy period of time over which they took place, there is not that degree of consistency of occurrence that is required to enable a conclusion to be reached that the pattern of buying a section, erecting a house, the family living in it, and then selling it, is a regular pattern. Thus the Objectors have established the facts necessary to bring themselves within the exemption in subs.(2).

CONCLUSION:

My conclusion that the exemption applies makes it unnecessary for me to consider the arguments advanced by the Objectors relating to the disallowance by the Commissioner of the rates and interest incurred on Newells Road.

The determination of the Court is that the Commissioner acted incorrectly in disallowing the Objectors' objections to the assessments. They should be amended by omitting from the assessments of each Objector one-half of the profit of Newells Road of \$20,473.50, less one-half of the loss on Ashbury Avenue of \$1,250.

The Objectors are entitled to costs on the hearing of the case stated which I fix at \$800.

W. H. Williams

Solicitors:

Norris, Ward & Co
~~McLeod, Stevens & Partners~~, Hamilton, for Objectors.

Crown Law Office, Wellington, for Commissioner.