



**MINISTRY OF FINANCE AND ECONOMIC MANAGEMENT
GOVERNMENT OF THE COOK ISLANDS**

Collector's Ruling **2013/03**

SUBJECT: **Taxation of Land Transactions**

Background

This ruling is intended to provide guidance on the tax implications of land transactions.

Land Ownership

Before considering the tax implications it is important to understand land ownership in the Cook Islands.

- 1 Ownership: Land ownership rests with the customary owners, through family/ancestral links. Individuals or family may approach the customary owners for a **right to occupy** or **lease** the land.
- 2 Occupational Right: With the majority (51%) consent of fellow landowners an individual linked to the title through genealogy may apply to the High Court for a right to occupy the property. This may be a residential or commercial right to occupy a section of land. No money is exchanged.
- 3 Leases: With majority (51%) consent, landowners may grant a lease (often 60 years) to any Cook Islander, permanent resident, or foreigner who has been given approval to carry on business in the Cook Islands. This requires approval from the leases tribunal and High Court confirmation.
- 4 Assignment of a Lease: The lessee may assign a partly used lease.
- 5 Sublease: The lessee may also sublease their lease (or part of their lease) to a third party.
- 6 Land Transactions: Documents used in land transactions include; vesting deed, deed of lease between the landowner and the lessee, and deed of assignment. Often the assignment of a lease is part of the sale of a business and will be included in a sale and purchase agreement.

The Collector is aware that there are some anomalies in terms of how people acquire title, or the right to use land. For example, there are cases where land swaps have taken place involving an Aitutakian swapping land in Aitutaki for land in Rarotonga, or land taken in the National interest for roads, etc, or landowners gifting land to long time friends. In these cases taxpayers are advised to seek professional advice regarding the tax consequences or write to the Collector for a ruling.

Note: At the end of the lease, ownership reverts to the customary owners.

Tax Laws

All legislative references are to the *Income Tax Act 1997* unless otherwise stated.

Section 46 Items included in assessable income

(1)(c) all profits or gains derived from the sale or other disposition of any real or personal property or any interest therein, if the business of the taxpayer comprises **dealing in such property**, or if the property was **acquired for the purpose of selling or otherwise disposing of it**, and all profits or gains derived from the carrying on or carrying out of any **undertaking or scheme** entered into or devised for the purpose of making a profit; (emphasis added)

(1)(d) all rents, fines, premiums, or other revenues (including payments for or in respect of the goodwill of any business, or the benefit of any statutory licence or privilege) **derived by the owner of land from any lease, licence, or easement affecting the land or from the grant of any right of taking the profits thereof**; (emphasis added)

(1)(e) all royalties or other like payments dependent upon production from or the use of any real or personal property, whether or not they are instalments of the purchase price of any property;

Section 47 Income derived from use or occupation of land –

(1) The assessable income of any person shall, for the purposes of this Act, be deemed to include –
(a) all profits or gains derived from the **use or occupation of any land**; (emphasis added)

Section 50 Apportionment of income received in anticipation –

(1) When income is derived by any person in any year by way of **fines premiums or payment for goodwill on the grant of a lease or in any other like manner** by way of anticipation the Collector at the request of that person during the next succeeding year may **apportion that income** between the income year and any number of **subsequent years not exceeding five**, and the part so apportioned to each of those years shall be deemed to have been derived in that year and shall be assessable for income tax accordingly. (emphasis added)

(2) Any such apportionment may be at any time cancelled by the Collector and thereupon the income so apportioned or the part thereof on which income tax has not yet been paid shall become assessable for income tax as if derived during the year preceding that in which the apportionment was so cancelled.

Section 61 Deductions in respect of buildings on native leaseholds –

(1) The Collector, in calculating the assessable income derived by any taxpayer during any income year, may allow such deduction as the Collector thinks fit in respect of any sum expended by the taxpayer –

(a) in acquiring or erecting any building on any native freehold land which the taxpayer holds on lease; or

(b) in purchasing the unexpired period of any lease of native freehold land.

(2) In ascertaining the amount that may be deducted under this section in respect of any income year, the amount expended by the taxpayer in respect of the acquisition or erection of the building or in respect of the purchase of the lease shall be apportioned by the Collector over the unexpired period of the lease (including any period in respect of which a right of renewal exists) calculated from the date of the acquisition or erection or purchase as the case may be (whether that date falls before or after the coming into force of this Act), and the amount deducted in respect of any income year shall not in any case exceed the amount apportioned to that year:

Provided however that in ascertaining the amount to be deducted the Collector shall take into account the amount by which the value of any building has already been reduced by the allowance of depreciation under the provisions of any previous legislation relating to the payment of income tax: and

Provided further that where the unexpired portion of a lease is sold to any company over which the vendor has control, as defined in section 3, or to any partnership over which the vendor has control, the amount of

the annual deductions shall be limited to the amount to which the vendor would have been entitled had the sale not taken place.

(3) Where the Collector has for any year of assessment allowed a deduction under the provisions of this section and the taxpayer at any time afterwards sells the unexpired period of the lease, the Collector may make a revised assessment in respect of that year of assessment without allowing that deduction or without allowing such portion thereof as the Collector thinks fit, and may recover the additional amount of income tax accordingly.

(4) For the purpose of giving effect to subsection (3) the Collector may at any time alter any assessment notwithstanding anything in section 23.

(5) Where the unexpired period of the lease has been sold together with other assets of a business the consideration attributable to the sale of the lease and of any buildings erected on the demised land shall be determined by the Collector and the part of the consideration so determined shall be deemed to be the price at which the lease and buildings were sold by the vendor and purchased by the purchaser.

(6) A taxpayer to whom this section applies may elect whether to claim a deduction hereunder or to claim a deduction for depreciation under section 60, but any deduction made under this section shall be in substitution for any deduction for depreciation which may be allowable under section 60.

Section 62 Expenditure incurred in borrowing money or obtaining lease –

The Collector may, in calculating the assessable income of any taxpayer, allow such deduction as the Collector thinks fit in respect of expenditure incurred by the taxpayer during the income year for the preparation, stamping, and registration of any lease of property used in the production of the taxpayer's assessable income or of any renewal of such lease, or in the borrowing of money employed by the taxpayer as capital in the production of assessable income.

RULING

Section 46(1)(d) Revenue derived from land:

The income of any landowner includes any rent, fine, premium or other revenues (including goodwill of a business or the benefit of a statutory license or privilege).

Example 1 The customary owner of a piece of land grants a lease to David Jones. The terms of the agreement include goodwill on the granting of the lease of \$50,000 plus a yearly lease of \$10,000 per year. The goodwill on granting of the lease of \$50,000 plus the annual lease of \$10,000 (total \$60,000) is assessable income in year one to the customary owner. The yearly lease of \$10,000 is assessable each year thereafter. In this example the customary owners have not requested an apportionment pursuant to section 50.

Example 2 If David Jones subleased the property in example 1 to Andrew Greatbatch for \$15,000 per year. Also, the terms of the agreement include a payment for the grant of the sublease of \$200,000. The goodwill on granting of the lease of \$200,000 plus the annual lease of \$15,000 less his \$10,000 lease payments (total \$205,000) is assessable income to David in year one. The yearly lease of \$15,000 less his \$10,000 lease payments (total \$5,000) is assessable each year thereafter. Again, David did not request an apportionment pursuant to section 50.

Example 3 Tai Haynes is granted a lease of property from the customary owners for a lease of \$1,000 per year. She immediately subleases to Amy Willey. The terms of the agreement with Amy are a goodwill payment of \$70,000 plus a yearly rental of \$5,000. The goodwill payment of \$70,000 plus the yearly rent of \$5,000 less her yearly rent of \$1,000 (total \$74,000) are assessable income to Tai in year one. The yearly rental of \$5,000 less her lease payment of \$1,000 (total \$4,000) is assessable income each year thereafter.

Example 4 After operating her accommodation business for a number of years Michelle Gavisar sells her business, and as part of the agreement she assigns the lease to Amy Chappell. The sale, including the assignment of the lease will not be taxable.

Note 1 The goodwill on granting the lease is assessable income regardless of frequency, or intention to sell, or otherwise.

Note 2 There are likely to be numerous customary owners party to any agreement who will need to be made aware of their tax obligations resulting from the receipt of any lease payments.

Section 50 Apportionment of Income Received

In instances where income is derived from fines, premiums or goodwill on the granting of a lease the Collector upon written request may allow the income to be apportioned over a period not exceeding 5 years.

Example 5 Chris Richards subleases a property to Gavin Lloyd. The agreement included an upfront goodwill payment on the grant of the sublease for \$100,000. The \$100,000 is assessable income to Chris Richards. However, Chris writes to the Collector and requests that he apportion the income over 5 years. The Collector agrees and Chris includes \$20,000 as assessable income in his tax return for the next 5 years. He is entitled to a deduction for the lease he pays to the landowners.

Section 46 (1) (c) Dealer in Land:

Dealing in land suggests buying and selling of land on a reasonably frequent basis. The nature and regularity of the land transactions will be a matter of fact that the Collector would need to consider.

Example 6 Michael Crowe has bought and sold 9 accommodation businesses in the past 3 income years. The profit on these sales including the assignment of the lease will be taxable as Michael is considered to be a dealer in land.

Note: The disposition of more than 2 properties in two years or less is likely to attract the Collector's attention.

Section 46(1)(c) Purpose of selling

If the purpose of leasing the property was to dispose of it for a profit then any profits would be taxable. The purpose would be determined by the facts at the time of purchase.

Example 7: John Hadlee is aware of a foreign investor's interest in a property. He leases the property from the owner and then immediately assigns the lease to the foreign investor at a large profit. The profit will be taxable.

Note: The entering into of a lease and immediate disposal is likely to be taxable.

Section 46 (c) Undertaking of scheme for the purpose of profit:

An undertaking is a project to achieve an end result. A scheme is a plan to achieve an end result. Therefore a scheme and subsequent undertaking to construct a building and on sell it, with the associated land lease, would make the sale and disposal taxable. Even if it was a one –off event.

Example 8 Justin Garner owns an accommodation complex consisting of 100 apartments. He decides to sell five of the apartments as unit titles. The sales are taxable as Justin has undertaken a scheme for the purpose of profit.

Section 47 Use or Occupation of Land

This is a catch all provision that is intended to catch receipts from the use or occupation of land not otherwise treated as income.

Who to contact with any questions.

Please contact our office on telephone number 29365 if you have any questions in relation to this Ruling.

Please note that this Ruling is the Collector's view only and is non-binding.

This ruling is signed by me on the 30th day of December 2013.



Andrew Haigh
Collector of Inland Revenue