KPMG

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Regular commentary from our experts on topical tax issues

Issue 3

Budget 2015: Land sold within two years to be taxed

Snapshot

Ahead of this week's Budget, the Government has announced measures to tax certain residential property sales and increase disclosure requirements on such transactions. The proposals will deem a sale of residential property (other than the family home and limited other cases) within two years to be taxable, with effect for acquisitions after 1 October 2015.

Additionally, buyers and sellers will need to provide their IRD number and non-residents will need to have a New Zealand bank account to get an IRD number.

Inland Revenue will also be provided additional funding for compliance and enforcement of the new and current rules.

The changes, according to the Prime Minister, are aimed at ensuring residents and non-residents alike pay their fair share of tax.

The proposed two year rule does not exempt sales made after this period. Investors should be aware the current rules for taxing land will continue to apply.

The increased disclosure requirements are aimed at providing Inland Revenue with more information to track land sales. This should increase compliance.

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What's the problem?

No tax is being paid on land acquired with the intention of sale

Under current law, land acquired with the purpose or intention of sale is taxable when sold.

However, many purchasers acquire land with the initial purpose of rental. The New Zealand Courts have decided that purchasers in this position are not taxable, even if one of the other purposes is ultimately to sell the land. This effectively makes the test on acquisition a "dominant" purpose one.

It is difficult to distinguish those buying to sell, and renting until the property can be sold, and those acquiring for long term rental. Many will claim that they did not acquire to sell. Under New Zealand's self-assessment system, this means that Inland Revenue must find the sales which are taxable.

What's proposed?

Making sale of residential property within 2 years taxable

Any residential property acquired after 1 October 2015 and sold within two years will be taxable.

There will be exemptions for the family home, inherited land and land transferred under a relationship property agreement.

The existing tax rules (the purpose/intention test) will continue to apply to land sales after the two year period.

More funding for Inland Revenue to audit property transactions

The Government will provide Inland Revenue with an additional $29 million of funding for its property audit activity in Budget 2015, providing a total $62 million of funding for the next five years.

Additional disclosure requirements

Buyers and sellers of land, other than in transactions involving their main home, will need to provide their IRD number as part of the land transfer process.

Non-residents will also need to provide their home country tax identification number and have a New Zealand bank account to get an IRD number. The latter requirement ensures that New Zealand's Anti-Money Laundering rules apply to non-residents as well as residents.

Withholding tax on non-residents from 2016?

The Government is also considering applying a withholding tax to sales of residential property by non-residents. Non-residents will need to claim back any tax refunds.

Consultation and legislation

Consultation on the proposals will commence in July in anticipation of legislation in late August and the 1 October application date.

Who should take note?

The two year rule will be a particular focus for residential property investors. Importantly, it will mean that otherwise non-taxable gains, under the existing rules, will now become taxable.

The need to provide IRD numbers provides a simple means of matching a buyer and seller of property with Inland Revenue's records. This should encourage compliance but may generate costs (e.g. from having to maintain a NZ bank account for non-residents) and disputes over sales which are not taxable. Non-residents having to provide foreign tax identification numbers will allow better information sharing with their home jurisdictions.

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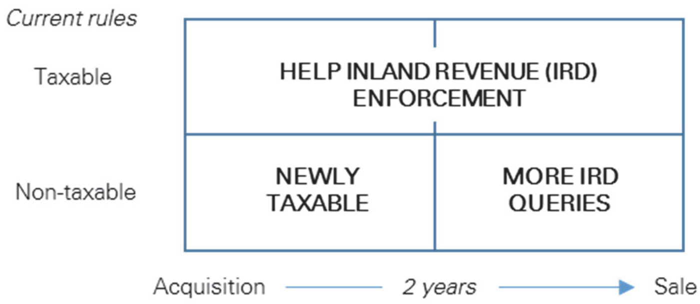
Our view

Holding for more than 2 years is not a "safe harbour" from being taxed

The proposed two year rule, while referred to as a "bright line" test, is not a safe-harbour. This is an important distinction. It does not exempt sales made after two years. However, it is likely to mean that an investor will now have as a matter of course a two year minimum holding period. The diagram below illustrates the position under the current and new rules:



The rule will tax investors who have not acquired with the intention of sale, who are forced to sell within two years. There are no exemptions proposed in these circumstances.

What land is in scope?

The Government's release refers to residential property investment being the target. It is not clear how this will legislatively be defined. Any definition will create uncertainty and scope for disputes.

The compliance impact

The $62 million provided to Inland Revenue is expected to generate $420 million of additional tax. It is unclear whether this additional tax is solely attributable to the two year rule or to Inland Revenue's enhanced enforcement. If investors' response is to defer sales, any additional revenue will only be raised through enforcement.

Inland Revenue's property audit focus to date has tended to be in specific geographical areas. That is likely to be its continued focus until it starts receiving land sale information by IRD number. The provision of IRD numbers will, in our view, encourage compliance.

However, taxpayers may be concerned that there appear to be no safeguards regarding the provision of IRD numbers. Presumably, this will be provided to Land Information New Zealand only and not published on the land title.

An important consequence of the new proposals is that information on the nature of investors acquiring property will be available. This should, in our view, provide a better basis for making policy going forward.

The first $64,000 question – will this slow the housing market?

The proposed changes may limit housing supply, in the short-term. Properties acquired after 1 October are likely to take longer to be placed on the market. This may create a further shortage of available properties for home buyers. In the longer term, perceptions of the market and therefore broader questions of supply and demand are more likely to dominate.

The second $64,000 question – a step to a capital gains tax?

The Prime Minister has noted that the proposals are about clarifying the operation of the current property taxing rules, not the introduction of a new tax. A comprehensive capital gains tax is not supported by the current Government.

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The new rule will bring more property investors into the tax net. However, it still means property investors who do not sell within two years and who do not acquire with the intention of sale pay tax on their rental income but not on the gains they make when they sell.

This difference may encourage those who do support a comprehensive capital gains tax to make their case again.

The final $64,000 question – what does this mean for other announcements in the Budget?

The expectation for tax announcements in the Budget were low. Generally, tax changes are signalled well in advanced, with the Budget simply confirming what is already expected. The timing of this announcement may mean there are other areas which the Government would prefer the Budget reaction to be focused on. This may be a hard ask given the topical nature of this issue.

Next steps

The July consultation will provide an opportunity to respond to the detail of the proposal. It is unlikely to alter the key proposal however.

For further information

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