The Special Report

Land Tax

Richard Ashby is a tax partner at Gilligan Sheppard Limited, who's been dealing with New Zealand taxation for over 29 years. Here he talks to *Finance Monthly* about the land tax and the new 'bright-line' rules, as well as the considerations that foreign buyers need to be aware of before acquiring land in New Zealand.

As a tax specialist interested in land tax, what are the most important considerations that must be taken into account when purchasing land in New Zealand?

Purely from a New Zealand taxation perspective, the two most important considerations are ownership structure, particularly where foreign investors are involved, and the expected taxation consequences that may arise for the owners of the land in the event of a subsequent disposal of the land.

What should foreign buyers be aware of when buying residential land for the purposes of investment to derive income or to use the land for their personal residence?

New Zealand is one of the few taxing jurisdictions in the world that does not have a capital gains tax. Consequently, where land is acquired for long-term investment purposes, including the use of the land as the owner's personal residence, any gain made on the subsequent disposal of the land will usually not be subject to any New Zealand tax. The tax free nature of the capital gain is attractive to foreign buyers therefore, because while they may still have an obligation to report and pay a capital gains tax in their own taxing jurisdiction, they have no exposure to any tax leakage in cases where the New Zealand tax payable on the income may have been greater than the local taxes payable on the income.

If the foreign buyer acquires the land for investment purposes to derive income, they will have an obligation to file a New Zealand income tax return each year and to pay New Zealand income taxes on the income derived from the land. Any income tax payable will be calculated based on the net income, that is, gross income less any expenses incurred by the owner in deriving that gross income. Common examples of expenses that may be claimed are interest costs associated with any debt used to acquire the land, local council rates and general maintenance costs. Most foreign jurisdictions that have a double tax treaty agreement with New Zealand, will permit their residents to claim a credit for any New Zealand income tax paid against the local taxes payable on the income.

So if a foreign buyer acquires the land for either investment purposes or to use as a personal residence, they never have to pay any taxes on any gain derived upon the disposal of that land?

Unfortunately no, it's not quite that simple, as there is a proviso to the previous statement, where residential land is acquired and subsequently disposed of within a two year period. Legislative changes in October 2015 introduced a new bright-line test, which essentially taxes any gain on a disposal of residential land that occurs within two years of when the land was acquired, unless the owner can show that the land was occupied as their main home.

Aside from the bright-line rules, there are also a number of provisions within the income tax legislation which may tax any gain arising upon a subsequent disposal of the land if the owner undertakes certain activities with respect to the land within ten years of the date the land was acquired.

What are the chances of the New Zealand Inland Revenue Department becoming aware of a foreign buyer acquiring land in New Zealand?

Twelve months ago I would have responded 50/50 at best, particularly where it was a one off investment as opposed to a foreign buyer regularly acquiring and selling New Zealand land. Now I would say 100%, again due to the legislative changes in October 2015. Any foreign buyer of New Zealand land now must provide a New Zealand tax file number (IRD number) at the time the land is acquired. Failure to provide a tax file number will prevent a transfer of the legal title of the land being registered in their name, in other words settlement of the transaction will be unable to proceed. This could result in the buyer potentially forfeiting any deposit already paid upon a breach of the contract terms or an interest cost being imposed by the seller of the land to compensate them for late settlement.

The disclosure rules have been strengthened further, by requiring a non-resident to have to provide evidence to the Inland Revenue Department of an active New Zealand bank account, in order to qualify for a tax file number to be issued to them.

> *"Effective from 1st July 2016, a residential land withholding tax will be required to be deducted from any disposal proceeds payable to the foreign seller."*

Is there anything else a foreign buyer should be aware of with respect to these new "bright-line" rules?

Yes, there is one further issue that applies solely to foreign buyers who are caught under the bright-line test because they have disposed of the residential land within two years of acquiring it. Effective from 1st July 2016, a residential land withholding tax will be required to be deducted from any disposal proceeds payable to the foreign seller. The withholding tax will in essence be the lesser of 33% of the sale price minus the acquisition cost, 10% of the sale price or the sale price less any outstanding rates less the qualifying debt repayable upon sale (qualifying debt usually equates to NZ registered bank debt).

If the foreign seller thinks they may have been overtaxed as a result of the deduction of the withholding tax, then they can file a claim with the Inland Revenue Department to obtain a refund of the excess.

Our discussion has focussed predominantly on residential land. Are the rules the same with respect to a foreign buyer acquiring commercial land?

With respect to the bright-line test, no, as these rules are only applicable to disposals of residential land. The bright-line taxing provision also only applies where no other existing land tax provision applies in the first instance. So for example, a foreign buyer in the business of developing land for the purpose of resale, will be taxed under the provision that applies to persons in the business of developing land in the first instance, and not the bright-line rules.

In absence of the bright-line rule therefore, a foreign buyer who acquires commercial land, for example land containing a warehouse, as a long term investment and for unforeseen reasons needs to dispose of the land within two years, may still derive a tax free capital gain. The risk for the foreign buyer in this scenario however, would be an assertion by the Inland Revenue Department that the short ownership period suggests a different purpose or intention of the foreign buyer at the date of acquisition of the land, being one of resale. Any land acquired with an intention or purpose of resale is subject to tax under the land tax provisions whenever sold.

Foreign buyers will need to file an annual income tax return in respect of the income derived from the commercial investment. As for residential investment land, New Zealand income tax would be payable on the net income derived – gross income minus allowable expenses.

Is there anything else you would like to add?

Seek advice from a reputable New Zealand professional who can demonstrate they have an in-depth knowledge of New Zealand's land tax provisions, prior to acquiring the land. The costs of getting it wrong associated with either not doing your homework or obtaining advice from an unqualified person, are simply too high.

Website: www.gilshep.co.nz