

Residential land withholding tax

An officials' issues paper

August 2015

Prepared by Policy and Strategy, Inland Revenue, and the Treasury

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CHAPTER 1

Introduction

- 1.1 As part of Budget 2015, the Government announced that it would introduce a “bright-line” test for the sale of residential property. An officials’ issues paper on the bright-line test was released in June 2015 for consultation. Draft legislation for the bright-line test was introduced in August and is expected to apply from 1 October 2015 to the sale of certain property acquired after that date.
- 1.2 The bright-line test will require income tax to be paid on any gains from the sale of most residential property that is bought and sold within two years, with the exception of the main family home. The purpose of the bright-line test is to supplement the “intention test” in the current land sale rules. The intention test taxes gains from the sale of real property purchased with an intention of disposal.
- 1.3 For the bright-line test to be effective, the Government needs to have an appropriate administrative mechanism for collecting the tax – particularly when the vendor of the property is not in New Zealand.
- 1.4 New Zealand imposes withholding taxes on certain types of New Zealand-sourced income earned by foreign investors – we impose withholding taxes on dividends, interest and royalties (known as non-resident passive income).
- 1.5 This issues paper suggests that a withholding tax be introduced on sales of residential property from 1 July 2016 where the vendor is a foreign investor (defined as an “offshore person” as in the Taxation (Land Information and Offshore Persons Information) Bill) who has owned the property for less than two years prior to the sale. This issues paper discusses the design of a withholding tax that would be consistent with the proposed bright-line test.
- 1.6 Officials are interested in feedback on the suggestions outlined in this paper, particularly in relation to who should be required to undertake the withholding and how the process may work in practice.

How to make a submission

- 1.7 Officials invite submissions on the suggested changes and points raised in this issues paper. Submissions should be addressed to:

Residential land withholding tax
C/- Deputy Commissioner, Policy and Strategy
Inland Revenue Department
PO Box 2198
Wellington 6140

- 1.8 Or email policy.webmaster@ird.govt.nz with “Residential land withholding tax” in the subject line. Electronic submissions are encouraged. The closing date for submissions is 2 October 2015.
- 1.9 Submissions should include a brief summary of major points and recommendations. They should also indicate whether it would be acceptable for Inland Revenue and Treasury officials to contact those making the submission to discuss the points raised, if required.
- 1.10 Submissions may be the subject of a request under the Official Information Act 1982, which may result in their release. The withholding of particular submissions, or parts thereof, on the grounds of privacy, or commercial sensitivity, or for any other reason, will be determined in accordance with that Act. Those making a submission who consider that there is any part of it that should properly be withheld under the Act should clearly indicate this.

Summary of proposal

The proposal in this issues paper is to introduce a requirement for an amount to be withheld on the sale of residential land in New Zealand by a conveyancer or solicitor to the property transaction and paid to the Commissioner of Inland Revenue (“the Commissioner”). The amount to be withheld would be the lower of:

- 33% of the vendor’s gain on that property (i.e. 33% x (agreed total sales price - vendor’s acquisition price)); and
- 10% of the total purchase price of that property.

This proposed “residential land withholding tax” or “RLWT” would come into effect from 1 July 2016. That is, conveyancers and solicitors would be required to act as withholding agents and withhold RLWT on affected transactions where settlement occurs on or after 1 July 2016.

As the proposed RLWT is intended to be a mechanism for supporting the collection of tax imposed under the bright-line test, we suggest that the withholding tax apply where the vendor of the residential property is both an “offshore person” and taxable under the bright-line test, because they have held the property for less than two years prior to the sale.

Note that while the proposed bright-line test would apply to residential land regardless of the geographic location, we suggest that the RLWT be restricted to residential land in New Zealand.

Under the proposed RLWT, a conveyancer or solicitor involved in the transaction would be required to withhold and pay the required amount to the Commissioner, unless one of the following circumstances applies:

1. The vendor is not an offshore person.
2. The sale of the property would not be taxable for the vendor under the proposed bright-line test because:
 - a. the vendor acquired the property being sold before 1 October 2015; or
 - b. the vendor acquired the property being sold after 1 October 2015, but the vendor has owned the property for two or more years.

The withholding agent should be entitled to rely on the statement provided by the vendor, unless they know it to be false. In such a case, the withholding agent would be required to withhold and pay RLWT to the Commissioner. A useful precedent for this approach is in section 78F of the Goods and Services Tax Act 1985 which permits a supplier to rely on a statement made by the purchaser that the conditions for zero rating the supply have been met.

The RLWT should be withheld before any other amounts are disbursed in relation to the sale of the property.

The proposed RLWT is not a final withholding tax. We propose that the vendor should be able to claim a tax credit for the amount of RLWT withheld and paid to the Commissioner against their final income tax liability in relation to the sale of the residential property. In some cases this may result in a tax refund.

Summary of different parties' obligations

Vendor

- Provide certified evidence showing whether they are or are not an offshore person (e.g. in the case of individuals, a copy of their passport, residence class visa and a statement that they have been physically present in New Zealand for the requisite period).
- Provide a certified copy of the vendor's sale and purchase agreement from the time of acquisition, if the vendor's title to the property being sold was registered on or after 1 October 2015, but the agreement for sale and purchase was entered into before 1 October 2015.

Withholding agent (either the purchaser's or vendor's conveyancing agent)

- Register as an RLWT withholding agent with the Commissioner.
- Confirm whether the vendor is eligible for an exception from withholding (i.e. not an offshore person or the residential property falls out of scope of the two-year bright-line test).
- Obtain the vendor's acquisition price to calculate whether the standard withholding rate or default withholding rate applies.
- Withhold the correct amount of RLWT at the time of settlement.
- Pay the withheld amount of RLWT to the Commissioner.
- Provide the required information in a form approved by the Commissioner at the time of payment to the Commissioner.

Purchaser (where there is no conveyancing agent)

- Verify whether the vendor is eligible for an exception from withholding (i.e. not an offshore person or the residential property falls out of scope of the two-year bright-line test).
- Verify the vendor's acquisition price to calculate whether the standard withholding rate or default withholding rate applies.
- Withhold the correct amount of RLWT at the time of settlement.
- Pay the withheld amount of RLWT to the Commissioner.
- Provide the required information in a form approved by the Commissioner at the time of payment to the Commissioner

CHAPTER 2

Background

Proposed bright-line test

- 2.1 As part of Budget 2015, the Government announced that it would introduce a “bright-line” test on the sale of residential property. The test will require income tax to be paid on any gains from the sale of residential property that is bought and sold within two years, with some exceptions. The new rule will apply to property acquired under an agreement for sale and purchase entered into on or after 1 October 2015.
- 2.2 The purpose of the bright-line test is to supplement the “intention test” in the current land sale rules. The intention test makes gains from the sale of real property purchased with an intention of disposal taxable. The intention test can be difficult to enforce due to its subjectivity. The bright-line test is intended to deal with the problem by supplementing the intention test with an objective test.
- 2.3 An issues paper on the design of the bright-line test was released in June 2015 and draft legislation was introduced on 24 August 2015 in the Taxation (Bright-line Test for Residential Land) Bill, following consultation on the issues paper.
- 2.4 The draft legislation proposes that:
 - The bright-line test would apply to residential land for which an agreement for sale and purchase is entered into from 1 October 2015, and which is subsequently disposed of within two years. When the property was acquired other than by way of sale, the suggested bright-line test would apply to properties for which registration of title occurs after 1 October 2015.
 - Residential land would be defined as:
 - land that has a dwelling on it;
 - land on which the seller is party to an arrangement to erect a dwelling; or
 - bare land that because of its area and nature is capable of having a dwelling erected on it; but
 - does not include land that is used predominantly as business premises or as farmland.
 - An exception should apply if the property is the owner’s main home.
 - An exception should apply for relationship property and inherited property.
 - Deductions should be allowed pursuant to ordinary tax rules.

- Losses should only be able to be offset against other land-sale gains (“ring-fencing”).
- A specific anti-avoidance rule should be introduced in relation to the use of land-rich companies and trusts to circumvent the bright-line test.

Compliance and collection of taxes

- 2.5 New Zealand taxes its tax residents on their worldwide income. New Zealand taxes foreign investors on income that is sourced in New Zealand. When a foreign investor has a branch or controls a subsidiary in New Zealand, tax can be imposed on the income of that branch or subsidiary in the same way as it would be on New Zealanders. However, when the foreign investor does not have a New Zealand presence, it is more difficult for New Zealand to collect tax from that person.
- 2.6 The Commissioner of Inland Revenue (“the Commissioner”) has a number of powers to enforce the tax obligations of taxpayers to assist in the collection of taxes.¹ However, these are not always administratively practical or effective, particularly when the taxpayer has no presence in New Zealand.
- 2.7 New Zealand can request help to collect tax from foreign investors from overseas revenue authorities under its various international agreements, including the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters, double tax agreements and tax information exchange agreements. These agreements allow for the exchange of tax-related information and assistance in the collection of taxes. While these are useful tools in enabling the Government to collect tax, they are a backstop and should not be the primary tool. As a practical matter, the most common and effective way to collect tax from foreign investors is a withholding tax.

Withholding taxes generally

- 2.8 Usually taxpayers file an income tax return which states the amount of their tax liability. The taxpayer pays their income tax once they have filed their tax return. However, in many situations that return-filing approach is supplemented, or is replaced by, a withholding tax.
- 2.9 Generally a withholding tax is an amount of tax that a person withholds when they make a payment to another person. The amount withheld is paid to the Commissioner and is the recipient’s (i.e. the payee’s) tax on the income from the payer. Withholding taxes are considered an important part of most tax administration systems because they ensure that the relevant tax is paid out of the amount due to the payee before the payee gets control of the funds. This makes it easier for the Commissioner to collect tax from taxpayers.

¹ The Commissioner may impose a number of monetary penalties, including, for example, late filing, shortfall, and late payment penalties. The Tax Administration Act 1994 sets out when and at what rates such penalties may be charged. This ensures that penalties for breaches of tax obligations are imposed impartially and consistently, at a level that is proportionate to the seriousness of the breach.

In addition, the Commissioner has powers available to recover amounts of unpaid tax. These powers include requiring deductions from payments made to the defaulter by any other person, and court action.

- 2.10 Withholding taxes are used to collect the tax liabilities of residents and non-residents alike, and can be non-final or final.
- 2.11 A non-final withholding tax is an estimate of the recipient's final income tax liability and the recipient may be required to file an income tax return. The recipient is able to claim a credit for the tax that has been withheld. One example of a non-final withholding tax is pay as you earn (PAYE), whereby an amount is withheld from a person's salary or wages on account of that person's income tax liability.²
- 2.12 A final withholding tax represents the final tax liability for the person from whom the tax has been withheld. An example of a final withholding tax is New Zealand's non-resident withholding tax (NRWT) regime in relation to certain types of passive income, such as dividends. The obligation to withhold NRWT is imposed on the payer, who is usually resident in New Zealand – which makes enforcement and collection easier.
- 2.13 The Commissioner has the ability to impose penalties on taxpayers who knowingly fail to deduct withholding tax from a payment they have made and on those who have withheld tax for any purpose other than for payment to the Commissioner.
- 2.14 While New Zealand does not currently have a withholding tax on property-related transactions involving non-residents, many other jurisdictions do – for example, Canada, Japan, and the United States. In addition, Australia has recently announced that it is introducing a withholding tax on sales of certain interests in land by foreign investors to support its capital gains tax.
- 2.15 In light of the proposed introduction of the bright-line test, we have considered whether the Commissioner's current tools for collection are appropriate and adequate. Given the general difficulty faced in collecting tax from foreign investors with no physical presence in New Zealand, we suggest the introduction of a non-final withholding tax on certain property-related transactions is needed to improve the collection of revenue.

² In many cases, where a person earns only salary or wage income and PAYE has been withheld at the correct rate, the person is not required to file an income tax return. In such a case, PAYE is considered to be final.

CHAPTER 3

The withholding agent

- 3.1 In this chapter we discuss who should be responsible for withholding RLWT.
- 3.2 As noted in the previous chapter, we suggest that withholding obligations under the RLWT should be effective from 1 July 2016.
- 3.3 In this and subsequent chapters, we use the term “conveyancing agent” to refer to conveyancers and solicitors involved in the property transaction (particularly in relation to the settlement and title transfer processes).

Who should have the withholding obligation?

- 3.4 The tax system aims to minimise the compliance burden it places on taxpayers. Therefore, as a starting point we propose that the withholding obligation fall on the conveyancing agent involved in the property transaction – rather than the vendor or purchaser themselves. That is, the conveyancing agent involved in the property transaction should be the RLWT withholding agent. This is because they already have professional obligations to discharge in relation to the conveyance of property and this would more naturally form part of those other obligations. They also have the systems and trust accounts needed to manage the funds involved in the settlement of property which is important in terms of ensuring the integrity of the withholding process.

Officials appreciate that requiring conveyancing agents to withhold RLWT would impose compliance costs and require changes to systems and processes. We are interested in receiving feedback on the compliance-cost aspect of the RLWT proposed in this issues paper.

- 3.5 Placing the obligation on the purchaser would be very difficult both in terms of compliance and administration. Placing the obligation on the vendor does not make sense because it would defeat the purpose of ensuring the RLWT is paid as part of the settlement process. Moreover, the vendor is already liable for income tax on the sale of the property – regardless of whether or not RLWT is withheld.³
- 3.6 The next question is which conveyancing agent should have the primary responsibility to withhold the tax – the vendor’s or the purchaser’s? There are advantages and disadvantages to either approach, which we have outlined below.

³ There is no “double taxation” because RLWT may be claimed as a credit by the vendor when the vendor files an income tax return.

We would like submitters to consider whether the primary obligation to withhold RLWT should lie with the purchaser's conveyancing agent, or the vendor's conveyancing agent.

Primary obligation on the purchaser's conveyancing agent

- 3.7 There are some advantages in requiring the purchaser's conveyancing agent to be the withholding agent.
- 3.8 In general, withholding taxes are used to ensure that the relevant tax is paid out of an amount due to a person before the recipient gets control of the funds. The recipient may have an incentive to spend the funds before tax has been paid, which is generally why tax administrations "clip the ticket" before the money reaches the recipient. In finding an appropriate party to clip the ticket, we consider it should be the person with the least to gain from failing to comply with the rules - this is normally the payer of the amount. This is particularly relevant to the problem here, as this withholding tax is aimed at enforcing the vendor's tax liability under the bright-line test.
- 3.9 New Zealand's withholding tax regimes commonly require the payer of an amount to withhold a portion from that payment and pay it to the Commissioner. Generally, the amounts of tax withheld are on account of the recipient of the payment. For example, when an employer withholds PAYE from an employee's salary or wages, it is on account of the employee. With interest payments, the payer (e.g. a bank) is required to withhold NRWT and RWT from a payment of interest, but the NRWT and RWT relate to the payee's tax liability.
- 3.10 This "payer as withholding agent" approach is the international norm for withholding taxes more generally, as well as for withholding taxes on sales of residential property. Under the withholding regime in relation to sales of real property in Canada, Japan and the United States, the primary liability to withhold is imposed on the purchaser (normally via their solicitor). In addition, Australia has recently proposed to introduce a withholding tax on sales of residential property to supplement its capital gains tax, where the primary liability to withhold would also be on the purchaser.
- 3.11 While the aforementioned countries place the legal obligation on the purchaser, it is expected that the purchaser will use an agent (a solicitor or conveyancer, for example) to handle their affairs.
- 3.12 Note that in the case of Canada, while the primary withholding obligation is on the purchaser, the obligation only arises if the seller cannot provide the purchaser with a "certificate of compliance". We understand that the seller is generally required to notify the Canadian Revenue Authority in advance of the property sale and square up their tax liability in relation to the property sale before a certificate of compliance is issued. Effectively, this means that withholding is only required in Canada if a non-resident has not fulfilled their tax obligations in relation to the property sale.

- 3.13 Another advantage of placing the primary obligation to withhold on the purchaser’s conveyancing agent is that the funds are likely to flow through a New Zealand solicitor’s trust account and so there would be funds in New Zealand from which RLWT can be withheld.
- 3.14 As a back-up, this approach allows a secondary obligation to withhold to be imposed on the vendor’s conveyancing agent. Having a “back stop” would be useful in the case of any misunderstanding between the two parties or if either the vendor or their conveyancing agent knows or discovers that the purchaser’s conveyancing agent failed to withhold or has withheld the incorrect amount. That is, the vendor’s conveyancing agent would be obliged to withhold RLWT and pay it to the Commissioner, if they know from the settlement statement and from the amount received on settlement that the purchaser’s conveyancing agent did not withhold RLWT or withheld insufficient RLWT. In the latter case, the vendor’s conveyancing agent would be obliged to withhold the difference. This could be streamlined by including an “RLWT calculation worksheet” in the conveyancing process and settlement statement.
- 3.15 There are also disadvantages in placing the primary obligation on the purchaser’s conveyancer.
- 3.16 The ultimate tax liability arising under the bright-line test belongs to the seller, not the buyer. Accordingly, it may be perceived as unfair to impose the compliance burden of the withholding on the purchaser and their agent. We note the compliance costs may or may not be economically borne by the buyer, depending on the price that buyers are willing to pay for a property.
- 3.17 A further difficulty with placing the primary obligation for withholding on the purchaser’s conveyancing agent would be that that conveyancing agent would need to decide whether or not withholding is required on any given transaction.
- 3.18 In order to address that difficulty, RLWT could apply unless one of two exceptions is available. In determining whether one of the exceptions is available it is proposed that the purchaser’s conveyancing agent would be able to rely on:
- information supplied by the conveyancer for the vendor; and
 - information contained in the databases established by Quotable Value or Landonline.
- 3.19 In summary, these are the main advantages and disadvantages we have identified in placing the primary obligation on the purchaser’s conveyancing agent:

Primary obligation to withhold RLWT on the purchaser's conveyancing agent	
Advantages	Disadvantages
<ul style="list-style-type: none"> International norm e.g. US, Canada, Japan (and soon Australia). Follows other New Zealand withholding taxes which place withholding liability on the payer (e.g. employers with PAYE, banks with RWT and NRWT). More likely for funds to flow through a New Zealand solicitor's trust account – therefore there are funds in New Zealand from which tax can be withheld. There is a “back stop”: if the buyer's conveyancing agent fails to withhold correctly, a secondary liability can be placed on the seller's conveyancing agent. 	<ul style="list-style-type: none"> Could be seen as unfair as the ultimate tax liability belongs to the seller. Requires the buyer's conveyancing agent to obtain information about the seller from the seller's agent. This may be seen as increasing the compliance burden on the buyer's agent and adding an additional cost to New Zealand buyers.

Obligation on the vendor's conveyancing agent

- 3.20 The other option is to place the obligation to withhold on the vendor's conveyancing agent.
- 3.21 Under this approach, the compliance burden and costs would be legally borne by the vendor. This could be seen as being fairer because the vendor is the person with the ultimate tax liability.
- 3.22 In addition, the vendor's conveyancing agent is likely to be familiar with their client's personal situation. This means the conveyancing agent will be in a position where they have more immediate access to information about the vendor's offshore status. In terms of the information that a withholding agent would need to collect in order to determine whether RLWT should be withheld (and at what rate), we think that determining whether the vendor is an offshore person would be the most resource intensive part of the process.
- 3.23 Another advantage is that the vendor's solicitor is generally responsible for paying the vendor's other expenses relating to the property sale out of the funds received upon settlement, before releasing the net amount to the vendor. This includes the payment of the seller's mortgage on the property and costs apportioned between the purchaser and vendor (e.g. rates and other levies relating to the property). As the vendor's solicitor already deals with these other expenses, it may be straightforward for them to also withhold and pay the RLWT to the Commissioner.
- 3.24 In contrast to placing the primary obligation on the purchaser's conveyancing agent, one disadvantage of this approach is that it is contrary to international norms and is contrary to New Zealand's current withholding tax regimes, where the withholding liabilities are imposed on the payer. The liability to withhold is generally placed on the payer because they are seen as the party to the transaction with the least incentive to not comply with the rules.

- 3.25 We understand that while a New Zealand conveyancing agent is required to undertake the title transfer process in Landonline, they may not be involved in the funds transfer process. As the vendor is an offshore person, there is the possibility that their solicitor is not based in New Zealand. If the New Zealand conveyancer is not involved in the funds transfer process, there are no funds from which the New Zealand conveyancer can withhold the required amount of RLWT. If the vendor uses a foreign solicitor, it may be more difficult to impose and enforce withholding obligations on that foreign solicitor. In addition, the funds may not go through a bank account controlled by a New Zealand conveyancing agent. If this is the case, a solution to this problem would need to be found.
- 3.26 Another disadvantage in placing the liability on the vendor's conveyancing agent is that it would effectively place the sole responsibility for withholding on the vendor's conveyancing agent. This is because the vendor's conveyancing agent is the final "link in the chain" before the funds reach the vendor's hands and so there would be no further opportunity to impose a secondary withholding liability if the vendor's conveyancing agent fails to withhold RLWT.
- 3.27 In summary, these are the main advantages and disadvantages we have identified in placing the primary obligation on the vendor's conveyancing agent:

Obligation to withhold RLWT on the vendor's conveyancing agent	
Advantages	Disadvantages
<ul style="list-style-type: none"> • Could be seen as being fairer for buyers – the compliance burden and cost are legally borne by the seller (i.e. by the person with the ultimate tax liability). • The seller's conveyancing agent may have more immediate access to information about the seller's offshore status. • The seller's conveyancing agent deals with other expenses at the time of settlement (e.g. mortgage and rates). 	<ul style="list-style-type: none"> • Contrary to international norms. • Contrary to New Zealand's current withholding taxes where the withholding liability is on the payer. • The New Zealand conveyancing agent undertaking the final title transfer may not be involved in the funds transfer and so may not have access to the funds from which tax is to be withheld. • There is no "back stop".

Compliance burden

3.28 In terms of the compliance burden, we do not consider there to be a significant difference between placing the obligation to withhold RLWT on the purchaser's or the vendor's conveyancing agent. One point to note is that the compliance burden is not necessarily borne by the party who is legally required to undertake the withholding. For example, where the withholding obligation is on the vendor's conveyancing agent, the vendor could pass the compliance cost onto the purchaser by requiring a higher sales price.

No conveyancing agent

3.29 There may be situations where a sale of residential land does not involve a conveyancing agent.

3.30 Where there is no conveyancing agent involved in the transaction, we propose that the primary withholding obligation falls on the purchaser. A secondary obligation could also be imposed on any agent or other person in New Zealand who receives payment on behalf of the vendor, similar to the obligation in section RF 4 of the Income Tax Act 2007 in relation to non-resident passive income.

CHAPTER 4

The rate of RLWT

- 4.1 We propose that the rate of RLWT to be withheld would be the lower of:
 - 33% of the vendor's gain (the "standard RLWT rate"); and
 - 10% of the purchase price of the property (the "default RLWT rate").
- 4.2 The "lower of" approach suggested in this chapter allows the withholding agent to undertake a simple calculation based on publicly-available information and other information available to both parties, while also minimising the level of necessary contact between the solicitors or conveyancers for the purchaser and vendor.
- 4.3 We suggest that this "lower of" approach strikes a balance between creating a collection mechanism that approximates the amount of tax payable under the bright-line test and making the process straightforward for the withholding agent.

The standard RLWT rate

- 4.4 We consider that the standard RLWT rate should generally apply to calculate the RLWT obligation – except in rare cases where it is not possible to apply or it results in more RLWT being withheld than the default rate (see below). The standard RLWT rate would be calculated as:

$$\text{RLWT} = 33\% \times (\text{total purchase price} - \text{vendor's acquisition price})$$

- 4.5 In other words, the standard RLWT rate calculates the vendor's gain based on the total purchase price agreed between the purchaser and the vendor less the cost at which the vendor acquired the property. The top marginal tax rate of 33% is then applied to the gain.⁴ The resulting amount is the RLWT that should be withheld.
- 4.6 Where the vendor's acquisition price is equal to or exceeds the total purchase price, no RLWT is required to be withheld. Officials consider this to be an appropriate outcome where the vendor makes a loss on the sale of the property.

No other deductions allowed for determining standard RLWT rate

- 4.7 It is not proposed to allow any deductions other than the vendor's acquisition price in calculating the gain for the purposes of determining the amount of RLWT to be withheld.

⁴ This 33% rate is consistent with the resident withholding tax rate on dividends.

- 4.8 The bright-line test allows certain deductions against the purchase price in determining the amount of the tax liability. More specifically, deductions are allowed under ordinary rules. Losses from other land sales may be offset against a gain.
- 4.9 The problem with allowing these deductions in calculating RLWT is that it would fall to the conveyancers to determine the amount and deductibility of expenditure. Often complex and technical tax issues can arise in determining whether a deduction is allowed. This would impose considerable compliance costs on withholding agents who are not in a position to determine these matters without seeking advice from tax advisors or Inland Revenue. There would also be compliance costs for withholding agents in verifying that the deductions claimed are real and genuine.
- 4.10 Accordingly, a taxpayer who wishes to claim other deductions against the taxable gain (including perhaps losses on transactions arising after the sale of a residential property) will need to file an income tax return. The process for this is outlined in chapter 7.

At-cost disposals

- 4.11 In some situations, a person may be deemed to have acquired residential land from another person “at cost”. This could occur, for example, under a relationship property agreement where the transferee takes on the transferor’s cost base.
- 4.12 Officials do not consider that an exception from RLWT is necessary for these sorts of disposals, because the “lower of” approach would result in no funds being withheld under RLWT due to the use of the standard RLWT rate.

The default RLWT rate: 10% of the purchase price

- 4.13 As the objective of the RLWT is to approximate the vendor’s final tax liability arising under the bright-line test, officials consider that a default 10% rate would strike a fair balance between maintaining simplicity, minimising compliance costs and not overestimating the vendor’s expected final tax liability.
- 4.14 Accordingly, we suggest that RLWT applies at a default rate of 10% of the total purchase price of the residential land. In general, the default rate would apply in situations where the conveyancing agent cannot calculate the standard rate because there is insufficient information regarding the acquisition price or there is no acquisition price. In rare cases, it may be that the amount that should be withheld under default rate is lower than under the standard rate.
- 4.15 A 10% rate is used in a number of jurisdictions including Japan and the United States. However, some countries have much higher rates – for example, the withholding rate in Canada is 25% of the purchase price (and in certain cases, 50%). Australia recently announced a 10% withholding tax

rate on sales of land and certain interests in land – albeit that measure is targeted at business assets and high-value residential properties.

- 4.16 Calculating the default rate based on the purchase price differs from New Zealand's approach to RWT and NRWT, which apply on a per-payment basis. Calculating RLWT on a total purchase price basis eliminates issues that may arise when consideration for the property is made in a number of instalments.

Example:

Jane acquired a residential property for \$800k after 1 October 2015 and after one year enters into a contract to sell the property to Paul for \$900k. Jane's gain is \$100k (\$900k - \$800k). This means that the amount of RLWT that should be withheld under the standard rate is \$33k (33% x \$100k). \$90k would need to be withheld under the default rate (10% x \$900k). Under the "lower of" approach, \$33k should be withheld by the withholding agent and paid to the Commissioner.

CHAPTER 5

Fulfilling RLWT obligations

5.1 A withholding agent's obligations under the RLWT consist of three key elements:

- the obligation to determine whether or not RLWT should be withheld and the amount that should be withheld;
- the obligation to withhold an amount from the payment or other consideration provided by the purchaser of residential land to the vendor and to deposit that amount in a trust account; and
- the obligation to pay this withheld amount to the Commissioner.

In what circumstances should RLWT be withheld?

5.2 As mentioned above, the main objective of the RLWT is to collect tax liabilities arising under the proposed bright-line test and in particular, from foreign investors. It follows from this that the RLWT should mirror the concepts and definitions used in the proposed bright-line test where possible and practical.

5.3 This means the withholding agent would be required to withhold and pay RLWT to the Commissioner on the sale of residential land, unless the vendor qualifies for either of the following exceptions:

- they are not an offshore person;
- the bright-line test does not apply to the sale of the property as a result of the two-year holding period being exceeded.

Not an offshore person

5.4 We suggest that the first exception should be where the vendor is not an "offshore person". This first exception would rely on the proposed definition of offshore person in the Taxation (Land Information and Offshore Persons Information) Bill.

5.5 The definition of "offshore person" in that bill covers both individuals and non-individuals (for example, trusts and companies).

5.6 For individuals, a New Zealand citizen or person who holds a residence-class visa granted under the Immigration Act 2009 will generally not be classed as an offshore person unless:

- in the case of citizens, they have not been in New Zealand within the last three years; and

- in the case of residents, they have not been within New Zealand for the last year.

Non-individuals

- 5.7 A non-individual will be an “offshore person”, if they would be an overseas person under sections 7(2)(b)–(e) of the Overseas Investment Act 2005 (modified to include the test for individuals described above). This test looks through structures that are New Zealand-tax resident and looks at their underlying ownership or control. The test is necessary to prevent offshore individuals circumventing the rule by interposing a New Zealand-resident structure.
- 5.8 Generally speaking this means a non-individual will be treated as being “offshore” if:
- it is a body corporate (such as a company) and:
 - it is incorporated outside New Zealand; or
 - 25 percent or more of its shares are owned by a body corporate incorporated outside New Zealand; or
 - an offshore person(s) has 25 percent or more of:
 - any class of securities;
 - the power to control the composition of its governing body; or
 - the right to exercise or control the voting power;
 - it is a partnership or other unincorporated body of persons (other than a trust) and:
 - 25 percent or more of its partners or members are offshore persons;
 - an offshore person(s) has a beneficial interest in or entitlement to 25 percent or more of the profits or assets (including on winding up); or
 - an offshore person(s) has the right to exercise or control the exercise of 25 percent or more of the voting power at a meeting;
 - it is a trust and an offshore person(s):
 - constitute 25 percent or more of its governing body; or
 - has a beneficial interest in or entitlement to 25 percent or more of the trust property; or
 - are 25 percent or more of those that have the right to amend or control the amendment of the trust deed; or
 - are 25 percent or more of those having the right to control the composition of the trust’s governing body; or
 - it is a unit trust and an offshore person(s):
 - are the manager or trustee, or both; or
 - has a beneficial interest in, or entitlement to, 25 percent or more of the trust property.

- 5.9 While the proposed bright-line test would generally apply to all purchasers and sellers of residential land (regardless of their tax residence or physical presence), the rationale for using the offshore person test is that the issue that the proposed RLWT is addressing relates to the effective collection of tax from foreign investors who will often have no physical presence in New Zealand. We do not think the alternative of basing the exception on tax residence would be practical, because it is a tax concept that cannot easily be applied or verified by a conveyancer or solicitor.
- 5.10 The vendor would be required to provide certified evidence to the withholding agent in order to confirm that they are not an offshore person. This could include a New Zealand birth certificate, or a passport, or other relevant documentation (including a statement that they have been physically present in New Zealand for the requisite period). In the case of a non-individual, the vendor would need to provide relevant information or documentation regarding the ownership (or membership) of the governing body.
- 5.11 Copies of such documents that are certified true copies should be able to be relied upon by the withholding agent.

Two-year period in bright-line test exceeded

- 5.12 As the proposed RLWT relates to the collection of tax arising under the proposed bright-line test, we suggest that an exception be provided where the vendor exceeds the two-year holding requirement for taxation under the bright-line test.
- 5.13 This means that a vendor would be able to access this second exception where:
- the vendor acquires the residential land being sold before 1 October 2015; or
 - the vendor acquires the residential land being sold after 1 October 2015, but has owned the residential land for two or more years when it is sold to the purchaser.
- 5.14 The dates of acquisition and disposal for the purposes of RLWT should be consistent with the final design of the bright-line test. The Taxation (Bright-line Test for Residential Land) Bill proposes that the date of acquisition would generally be the vendor's date of registration of the land title and the date of disposal would be the date on which the vendor and purchaser enter into an agreement for the sale of the property.
- 5.15 The withholding agent would be entitled to rely on information from Quotable Value Limited or Landonline as to the relevant dates.
- 5.16 Note that the proposed bright-line test would apply where an agreement for sale and purchase is entered into on or after 1 October 2015. In the case where an agreement for sale and purchase is entered into before 1 October 2015, but the date of registration does not occur until after 1 October 2015,

the vendor would need to provide a certified true copy of the agreement for sale and purchase (which is dated before 1 October 2015) to prove that the bright-line test does not apply.

- 5.17 One potential concern relates to the interaction between the intention and bright-line tests. The proposed bright-line test is intended to supplement the intention test and there may be instances where a person satisfies both tests. In such a case, RLWT should still apply – an offshore person should not be able to avoid the RLWT simply because another test also applies. This is because difficulties arise in collecting tax from foreign investors, regardless of which provision applies to impose the tax liability.
- 5.18 We propose that the RLWT should apply to “residential land” as defined for the purposes of the bright-line test. The proposed definition of “residential land” in the Taxation (Bright-line Test for Residential Land) Bill includes:
- land that has a dwelling on it;
 - land for which the seller is party to an arrangement that relates to erecting a dwelling on it;
 - bare land that because of its area and nature is capable of having a dwelling erected on it;
 - but excludes land that is used predominantly as business premises or farmland.

When does the withholding obligation arise?

- 5.19 While the RLWT applies to the total purchase price of the residential property, we suggest that the obligation to withhold RLWT arises on the day the contract is settled.
- 5.20 The obligation to withhold an amount would be fulfilled by deducting the RLWT from the amount to be paid to the vendor or the vendor’s conveyancing agent. As a practical matter, the settlement statement documenting all the relevant calculations for the property transaction is prepared by the vendor and should include the amount of RLWT that the vendor’s solicitor expects to be withheld.
- 5.21 In some situations, a deposit may be paid prior to settlement. We do not think that an obligation to withhold RLWT should arise at the time the deposit is paid as transactions can fall through even after a deposit is paid.

Example:

Peter agrees to purchase a residential property from Jess for \$1 million who is an offshore person. Jess purchased the property one year earlier for \$800k. Under the standard rate, the amount of RLWT to withhold in relation to the sale is \$66k ($33\% \times (\$1m - \$800k)$). Under the default rate, the amount of RLWT to withhold is \$100k. \$66k is the amount of RLWT that should be withheld. Prior to settlement, Peter pays a \$300k deposit. RLWT is not required to be withheld upon payment of the deposit. On settlement day, the \$66k RLWT liability is required to be withheld from the \$700k payment made to Jess.

- 5.22 If the withholding agent fails to withhold the correct amount of RLWT and pay this amount to the Commissioner, they may be liable for a monetary penalty. The Tax Administration Act 1994 sets out when and at what rates such penalties may be charged. This ensures that penalties for breaches of tax obligations are imposed consistently, at a level that is proportionate to the seriousness of the breach. Penalties under the RLWT could be set in accordance with other penalties in the Tax Administration Act 1994.

Discharge of other obligations upon settlement

- 5.23 As mentioned, most countries place the withholding obligation on the purchaser or, in effect, the purchaser's solicitor. This means that as a practical matter, the payment of the withholding tax occurs before any other payments are made in relation to the property.
- 5.24 We consider this should be the result for the RLWT, regardless of who bears the withholding obligation. If the payment of the tax ranked equally or behind other disbursements (e.g. repayment of mortgages) or other charges, RLWT could be easily avoided by taking out a loan or increasing an existing loan just before the sale of the property. In any event, our expectation is that the standard RLWT rate would be used in the majority of cases. This means that in the case where the property value has declined, there would be no RLWT and it should not affect the repayment of mortgages and other obligations of the vendor.

Example:

Mary purchases a residential property for \$500k, with a \$400k mortgage secured over the property. 18 months later Mary agrees to sell the property to Dan for \$450k. Using the default RLWT rate, the amount to be withheld would be \$45k. Combined with other expenses to be paid upon settlement (e.g. rates), this may leave insufficient funds to repay Mary's mortgage. However, by applying the standard RLWT rate, no withholding is required because Mary's acquisition price exceeds the sales price agreed between Mary and Dan. This means that under a "lower of" approach, the standard rate would be used and withholding would not be required.

Example:

Ben purchases a residential property for \$300k, with a \$300k mortgage secured over the property. One year later he agrees to sell the property to Elizabeth for \$320k. Using the default RLWT rate, \$32k would be required to be withheld. If the default RLWT rate applied, Ben would be unable to repay his mortgage. Applying the standard RLWT rate means that only \$6,600 ($33\% \times (320k - 300k)$) would need to be withheld. This would leave sufficient funds remaining to discharge Ben's mortgage.

Payment of withheld amounts to the Commissioner

- 5.25 Conveyancing agents who handle large volumes of such transactions could incur compliance costs in paying each withheld sum at the time of each transaction. One possibility would be to allow conveyancing agents to pay withheld RLWT amounts on a monthly basis (or "batching").

- 5.26 We suggest that the standard due dates for withheld amounts could apply. For example, PAYE, RWT, and NRWT due dates are set out in section RA 15 of the Income Tax Act 2007.
- 5.27 However, we also suggest that withheld amounts could also be paid on a transaction-by-transaction basis. This may be preferred by the conveyancing agent where RLWT is only occasionally withheld. The parties to the property transaction may wish to negotiate for immediate payment of RLWT to the Commissioner, for example if the vendor would like to file an interim income tax return shortly after settlement and claim a credit for RLWT (this is discussed in further detail in Chapter 7).
- 5.28 From an administrative perspective, it would be possible to allow both batching and payment on a transaction-by-transaction basis. For example, a conveyancing agent may wish to make payments of withheld RLWT to the Commissioner on a monthly basis, but may agree with some vendors to make immediate payment to the Commissioner.
- 5.29 When completing the title registration on Landonline, an additional field could be introduced for the withholding, signifying that the RLWT obligations in relation to the transaction have been fulfilled and the appropriate amount has been withheld and has been or will be paid to Inland Revenue.
- 5.30 We do not consider that a delay in the payment of RLWT should delay the title registration process.

No registration of title

- 5.31 There may be situations where a sale of residential land does not involve a registration of title. This includes, for example, “off the plan” sales.
- 5.32 If the parties to the transaction are using conveyancers and/or solicitors, we propose that the primary withholding obligation falls on either the purchaser’s conveyancing agent or the vendor’s conveyancing agent as set out in chapter 3. If there is no conveyancing agent, we propose that the primary withholding obligation falls on the purchaser (also proposed in chapter 3).

CHAPTER 6

Information requirements

- 6.1 As discussed in chapter 5, we suggest that RLWT would apply unless the vendor is eligible for at least one exception.
- 6.2 The first exception, which would be available when a vendor is not an offshore person, would require the vendor to provide evidence to the relevant conveyancing agent regarding their status. An example is a certified copy of their passport and/or residence class visa along with a statement that they have been physically present in New Zealand for the requisite period. In the case of a non-individual, the vendor would need to provide relevant information or documentation regarding the ownership (or membership) of the governing body.
- 6.3 Under the second exception, which applies when the vendor acquired the property prior to 1 October 2015 or has held the property for more than two years, the vendor would generally not be required to provide information or evidence to the conveyancing agent.
- 6.4 The vendor's date of acquisition (which would align with the bright-line test) would likely be the date of registration of the title to the property, which can be obtained from Quotable Value and Landonline. The date of disposal for the purposes of the two-year test would likely be the date on which the agreement for sale and purchase between the purchaser and vendor is entered into. This date would be available to both parties, including their conveyancing agents.
- 6.5 There is one instance where we envisage that the vendor would be required to provide evidence to the conveyancing agent under the second exception. This would be when the vendor's title to the property being sold is registered on or after 1 October 2015, but the vendor is not subject to the bright-line test because the agreement for sale and purchase was entered into prior to 1 October 2015. In this case, the vendor would need to provide a certified copy of that agreement for sale and purchase to the conveyancing agent in order to qualify for the second exception.
- 6.6 Chapter 4 discussed the rate at which RLWT should be withheld. The “lower of” approach proposed in that chapter allows the withholding agent to undertake a simple calculation based on publicly available information and other information available to both parties, while also minimising the level of engagement between the two conveyancing agents.
- 6.7 To calculate the amount of RLWT to be withheld, the withholding agent would first need the total purchase price, as agreed between the purchaser and vendor, which will be available in the agreement for sale and purchase. The withholding agent would also need to obtain the vendor's acquisition price, which is readily available from Quotable Value for a nominal fee.

- 6.8 Officials consider that in general, the conveyancing agent should be entitled to rely on a statement provided by the vendor, unless they know it to be false. In such a case, the conveyancing agent would be required to withhold and pay RLWT to the Commissioner. A useful precedent for this approach is in section 78F of the Goods and Services Tax Act 1985 which permits a supplier to rely on a statement made by the purchaser that the conditions for zero rating the supply have been met.

CHAPTER 7

Tax credits and filing a tax return

- 7.1 New Zealand tax residents are required to pay tax in New Zealand on their worldwide income, while non-residents are only taxed on their New Zealand-sourced income.
- 7.2 A person's final income tax liability under the proposed bright-line test arises whether or not they are a New Zealand tax resident. In the case of non-residents, New Zealand would only tax New Zealand-sourced residential property gains. Section YD 4(12) in the Income Tax Act 2007 provides that income derived from the disposal of property situated in New Zealand has a source in New Zealand. In the case of New Zealand tax residents, worldwide residential property gains would be taxable in New Zealand.
- 7.3 One of the differences between the proposed bright-line test and the RLWT is that the RLWT only applies to sales of residential land by "offshore persons". It is expected that a large number of taxpayers with tax liabilities arising under the bright-line test would not have RLWT withheld.
- 7.4 Regardless of whether RLWT has been withheld, taxpayers with tax liabilities arising under the bright-line test would be required to file an income tax return.
- 7.5 Where RLWT has been withheld, the amount of RLWT withheld would not be final. The vendor should be able to claim a tax credit for the amount of RLWT withheld and paid to the Commissioner against their final income tax liability in relation to the sale of the residential property. The rationale for this is that the RLWT is intended to assist in collecting tax arising under the bright-line test and is not intended to be a final tax.
- 7.6 We acknowledge that when the final tax liability is calculated, the default rate could result in over-taxation. Allowing the use of the standard withholding rate should reduce the extent of over-taxation in most situations, because the standard rate should generally result in a lower amount being withheld than under the default rate. But even then, if too much tax has been withheld, the vendor must file an income tax return to claim the difference as a refund or use it as a credit to offset some other tax obligation (this will usually be the case where the vendor has deductible expenses to claim in relation to the property). Likewise, if more tax is owing than the amount of tax withheld, the vendor must file an income tax return and pay the additional tax.
- 7.7 We also suggest that taxpayers should be able to file an interim income tax return (depending on the circumstances) in order to obtain an RLWT refund, in the event that the amount of RLWT withheld exceeds the taxpayer's final tax liability for the sale.
- 7.8 Where a loss has been made (i.e. the vendor's original acquisition cost exceeds the total purchase price), no withholding under the RLWT would be

required. In this case, there is no over-taxation, but an income tax return would need to be filed in order to calculate losses.

- 7.9 Where a taxpayer has ring-fenced losses⁵ carried forward from previous sales under the bright-line test, these losses should be used first to offset the person's taxable income in relation to the property sale. Any amount withheld as RLWT would be creditable against the person's final income tax liability. Where losses are utilised and there is no need to offset some or all of the RLWT against the income tax liability, the remaining RLWT should be refunded.
- 7.10 However, for an RLWT credit or refund to be available, the RLWT must be withheld and paid to the Commissioner.⁶ This is to protect the integrity of the tax system and to prevent gaming where a credit or refund is issued, but the RLWT has not been withheld and paid to the Commissioner.

⁵ The proposed bright-line test ring-fences losses so they can only be used to offset gains on other land sales that are taxable under any of the land sale provisions.

⁶ As discussed in chapter 5, it would be possible for withholding agents to pay amounts of withheld RLWT to the Commissioner on a monthly or transaction-by-transaction basis. There may be cases where the vendor would like to file an interim income tax return shortly after settlement in order to obtain an RLWT refund. It would be up to the vendor and purchaser to come to an agreement that RLWT should be paid to the Commissioner as soon as possible, so that the vendor is able to obtain their refund without substantial delay.