Information pack: Residential land withholding tax (RLWT)

Key design features of the proposals in the officials' issues paper

August 2015

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Full version of the officials' issues paper can be found at www.taxpolicy.ird.govt.nz

Background: Budget 2015 measures

New "bright-line test" for taxing residential property sales

- Taxes gains from property bought and sold within 2 years
- Supplements the "intention test"
- Applies to property acquired from 1 October 2015

Collecting information about offshore buyers of New Zealand property

- Requiring IRD numbers and foreign equivalents of IRD numbers to be provided at time of purchase of property
- Offshore persons to have NZ bank account in order to get an IRD number

Budget 2015 included measures to ensure that people buying and selling residential property for profit – including overseas buyers – pay their fair share of tax

Background: why have a withholding tax?

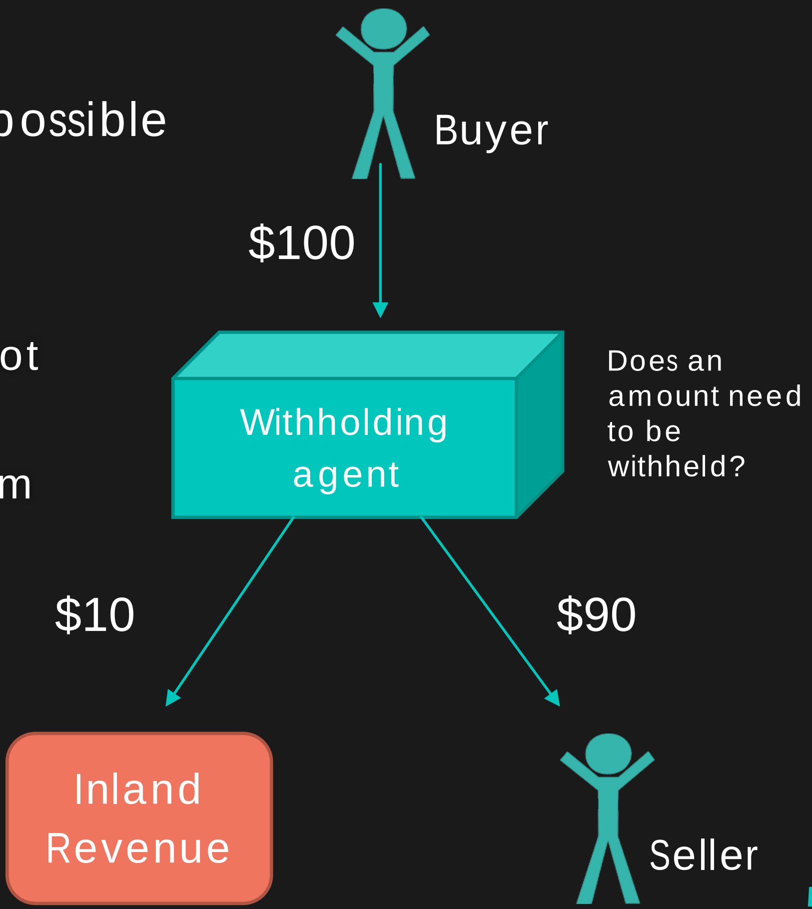
- It can be difficult to collect the tax due when the person has limited presence in NZ
- Withholding taxes on sales of property by non-residents are used in other jurisdictions (e.g. Canada, US, and soon Australia)
- A person receiving income may be tempted to spend the funds before tax has been paid. This is why withholding taxes are used to collect the tax due before the money reaches the recipient – the person paying the income does not have the same incentive to spend the funds. For example, employers deduct PAYE from their employees' wages.

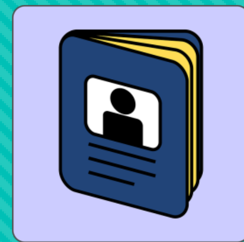
What would the RLWT involve?

We want to make the process as simple as possible for the withholder

Three key elements:

1. The obligation to determine whether or not withholding is required and at what rate
2. The obligation to withhold an amount from the payment made by the buyer of a property to the seller and to deposit that amount into a trust account
3. The obligation to pay this amount to the Commissioner of Inland Revenue





When would RLWT apply?

When all of the following conditions have been met:

1. The seller is an offshore person
2. The property being sold is residential land
3. The property is sold within two years of acquisition

Who is an “offshore person”?

- Definition covers both natural persons and entities
- Excludes:
  - NZ citizens who are or have been physically present in NZ within the previous 3 years
  - Individuals with residence class visas who are or have been physically present in NZ within the last year
- Includes entities incorporated outside NZ
- Includes entities incorporated in NZ but owned 25% or more by offshore persons

Follows the definition of “offshore person” used in the Taxation (Land Information and Offshore Persons Information) Bill

What is “residential land”?

Uses the proposed definition of residential land in the bright-line test:

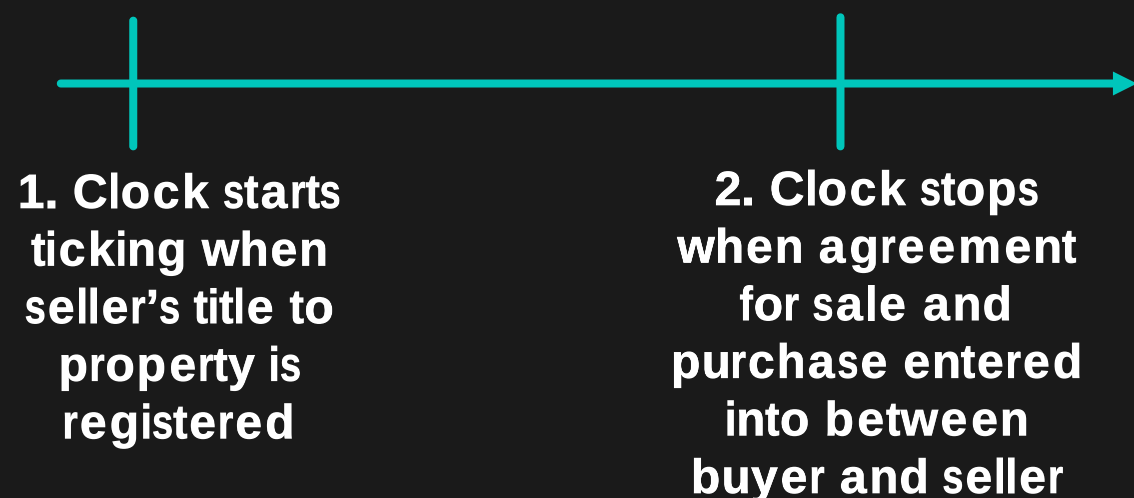
- Land with a dwelling on it
- Land for which the seller is a party to an arrangement that relates to erecting a dwelling on it
- Bare land that because of its area and nature is capable of having a dwelling erected on it
- But excludes land used predominantly as business premises or farmland

Follows the definition of “residential land” used in the Taxation (Bright-line Test for Residential Land) Bill

When the property is sold within two years of acquisition

- The seller acquires the residential land being sold on or after 1 October 2015 (where an agreement for sale and purchase is entered into on or after 1 October 2015)
- The seller owns the residential land for less than 2 years before selling it to the buyer

Follows the 2-year holding period proposed by the bright-line test



What would the rate of RLWT be?

The issues paper proposes that RLWT should be withheld at a rate that is the **lower of**:

1. 33% x seller's gain

   (the standard rate)

2. 10% x total purchase price

   (the default rate)

The standard rate

33% x seller's gain

Seller's gain = total purchase price – seller's acquisition price

Example
In April 2017, Mark enters into an agreement for sale and purchase with James to purchase James' residential property for $1 million. James is an offshore person and acquired the property in January 2016 for $750,000.

The amount of RLWT calculated under the standard rate is $82,500 (33% x ($1 million - $750,000)). This would mean that Mark pays $1 million and James receives $917,500 after withholding.

However, the amount of RLWT calculated under the default rate may be lower and should be calculated. Refer to pages 12 and 13 for further information.

- **Total purchase price:** agreed sales price between buyer and seller
- **Seller's acquisition price:** total price paid by seller to acquire the property (generally available from Quotable Value for a nominal fee)
- 33% is the top marginal tax rate (and is the rate used for resident withholding tax on dividends)

The default rate

- **Total purchase price** = agreed sales price between buyer and seller

10% x total purchase price

Example
In April 2017, Mark enters into an agreement for sale and purchase with James to purchase James' residential property for $1 million.

The amount of RLWT calculated under the default rate is $100,000 (10% x $1 million). This would mean that Mark pays $1 million and James receives $900,000 after withholding.

However, the amount of RLWT calculated under the standard rate would likely be lower and that amount would be withheld instead. Refer to page 13 of this information pack.

Calculating RLWT: an example

Example

In April 2017, Mark enters into an agreement for sale and purchase with James to purchase James' residential property for $1 million.

James is an offshore person and acquired the property in January 2016 for $750,000.

Standard rate: 33% x ($1 million - $750,000)

= 33% x $250,000

= $82,500

Default rate: 10% x $ 1 million

= $100,000

$82,500 is less than $100,000 and so $82,500 is the amount of RLWT that should be withheld.

January 2016
James acquires house for $750,000

April 2017
James sells house to Mark for $1 million

Amount of RLWT to be withheld: $82,500

Mark pays $1 million

James receives $917,500 after withholding

Who should be the withholding agent?

The buyer’s or seller’s conveyancer/solicitor?

In most circumstances, the buyer and seller will be using the services of a conveyancer or solicitor.

The issues paper sets out 2 options:

1. Primary obligation on the **buyer’s** conveyancing agent (with a secondary obligation on the seller’s conveyancing agent)
2. Sole obligation on the **seller’s** conveyancing agent

Where there is no conveyancer or solicitor involved in the property transaction, the obligation should be on the buyer.

The issues paper requests submitters’ feedback on which approach they prefer and any practical considerations.

Why not the buyer themselves?

- We think it would increase compliance costs and be administratively burdensome if every single buyer were to register as a withholding agent with Inland Revenue
- However, some countries put the actual obligation on the buyer
  - in the event of a failure to withhold, the tax authority would be able to enforce the obligation on the buyer for the amount that should have been withheld
  - It means that the withholding tax takes precedence over other expenses normally paid out by the seller's solicitor
- In reality, most buyers would rely on their solicitors or conveyancers to discharge their withholding obligations

How it might work: buyer’s conveyancing agent

1. James buys house for $750,000 in January 2016

2. Mark agrees to buy house from James for $1 million in April 2017

3. Mark puts $1 million into his conveyancer’s trust account

Mark’s conveyancer

4. James’ conveyancer provides evidence as to whether or not James is an offshore person

James’ conveyancer

Mark’s conveyancer:

5. calculates RLWT: $82,500 (see previous example)
6. Pays $917,500 to James’ conveyancer
7. Pays $82,500 to Inland Revenue

Inland Revenue

James’ conveyancer:

8. Checks correct amount of RLWT has been withheld
9. Pays relevant expenses (e.g. mortgage and rates)
10. Pays net proceeds to James ($917,500 less expenses)

How it might work: seller's conveyancing agent

1. James buys house for $750,000 in January 2016

2. Mark agrees to buy house from James for $1 million in April 2017

3. Mark puts $1 million into his conveyancer's trust account

Mark's conveyancer

4. Mark's conveyancer transfers $1 million to James' conveyancer

James' conveyancer

Inland Revenue

James' conveyancer:

5. Checks whether or not James is an offshore person
6. Calculates RLWT: $82,500 (see previous example)
7. Pays $82,500 to Inland Revenue
8. Pays other relevant expenses (e.g. mortgage and rates)
9. Pays net proceeds to James

Advantages of each approach

Buyer's conveyancing agent

- 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 buyer's conveyancing agent fails to withhold correct amount, a secondary liability can be placed on seller's conveyancing agent.

Seller's conveyancing agent

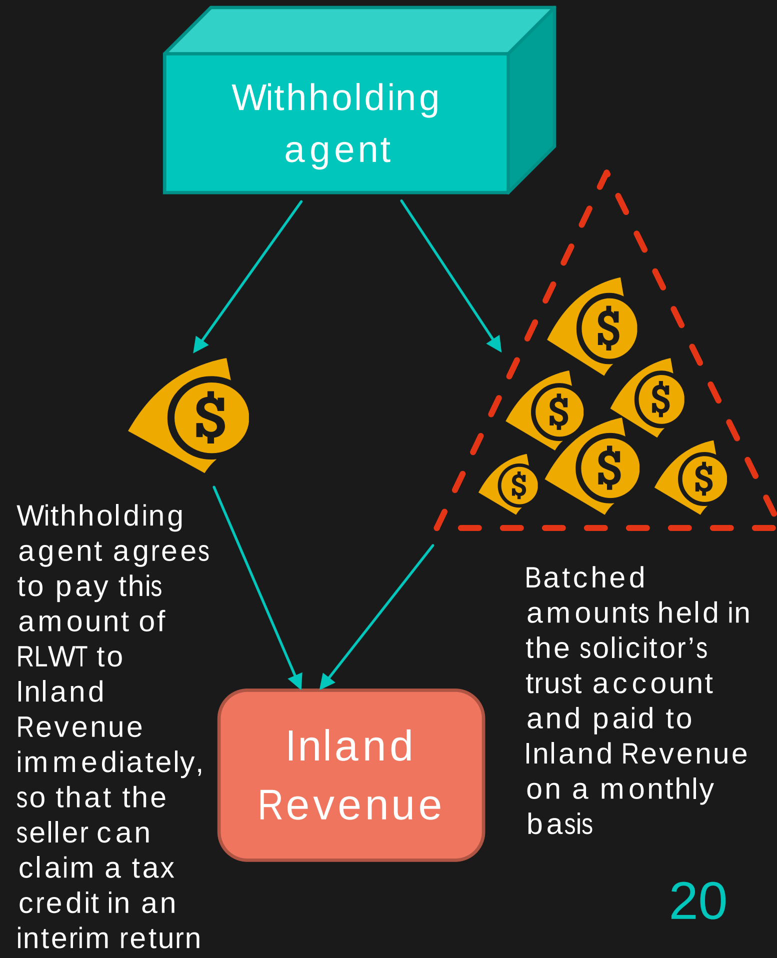
- Could be seen as being fairer for buyers - the compliance burden and cost are legally borne by the seller (i.e. by the person with the ultimate tax liability).
- The seller's conveyancing agent may have more immediate access to information about the seller's offshore status.
- The seller's conveyancing agent deals with other expenses at the time of settlement (e.g. rates).

Order of priority for disbursements

- Regardless of which approach is taken, we think that the withholding and payment of RLWT should occur before other payments are made in relation to the property (e.g. rates, repayment of the seller's mortgage)
- This is a natural result when the buyer or the buyer's solicitor or conveyancer is the withholding agent
- 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 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 impact the repayment of mortgages and other obligations of the seller.

Paying the money to Inland Revenue

- Withholding agents would need to register with Inland Revenue
- **Batching approach**: conveyancing agents who handle large volumes of such transactions could incur compliance costs to pay 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")
  - This is the approach taken for PAYE, RWT, and NRWT, for example. Standard due dates for withheld amounts could apply.
- **Transaction-by-transaction approach**: this may be preferred by the conveyancing agent where RLWT is only occasionally withheld. This would allow the seller to file an interim income tax return shortly after the sale and claim a credit for RLWT
- Would be possible to allow withholding agents to mix and match between the two approaches



Failure to withhold and pay RLWT

- The sale (in particular, the title transfer process) would *not* be held up as a result of a failure to withhold and pay RLWT
- The issues paper proposes instead that monetary penalties be imposed on the withholding agent where there is a failure to withhold and pay RLWT
  - 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.
  - RLWT penalties could be set in accordance with other penalties in the Tax Administration Act 1994.

Information needed by the withholding agent to apply RLWT

In the majority of cases, the required information to determine whether RLWT is payable and if so, to calculate RLWT should be able to be readily verified.

- **Offshore person:** the seller would need to provide evidence of whether or not they are an offshore person. This could include a New Zealand passport or a copy of their residence class visa (and if they are not physically present in NZ at the time of the sale, a statement as to their recent physical presence in NZ).
- **Residential land:** the seller's conveyancer or solicitor would need to certify whether or not the land is residential land.
- **2-year holding period:**
  - **Start date:** date of seller's registration of title to property (available from Landonline or Quotable Value). If registration after 1 October 2015, but seller entered into agreement for sale and purchase before 1 October 2015, seller needs to provide copy of contract to prove that the bright-line test does not apply.
  - **End date:** date of agreement for sale and purchase between seller and buyer (contract is available to both parties)
- **RLWT rate:**
  - **Total purchase price:** available in agreement for sale and purchase between seller and buyer (contract is available to both parties)
  - **Seller's acquisition price:** the total price paid by the seller (generally available from Quotable Value)

Credit for RLWT paid

- RLWT is not a final withholding tax – it is only a collection mechanism for the bright-line test
- The seller can claim a tax credit for RLWT in their income tax return
- The credit will only be available if the amount withheld has been paid to IRD
- In most cases, it should be possible to file an interim income tax return before the income year ends
  - A seller may want to do this shortly after a sale if RLWT results in over-taxation e.g. if the seller made capital improvements to the property
- Where RLWT results in over-taxation, a refund may be issued