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The New Zealand Taxation of Real Property Owned by Non-residents (Offshore persons)

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Introduction

- NZ government was facing increasing criticism and significant pressure to address property market
- Criticised for the inability to provide New Zealanders affordable housing, esp in Auckland
- Average house price has increased 57% during 2007-2015
- Calls for legislative intervention to correct the economic distortion

Introduction

- Media has often pointed the finger at the increasing number of residential properties being sold to non-residents
- Non-residents have been outbidding New Zealanders at auctions and perception that this is driving up house prices
- Perception that non-residents are not paying their 'fair share' of tax (ie John Key media release of 17 May 2015)
- Also considerable speculating in land, driving up house prices

Introduction

- NZ is one of the few OECD Nations not to have a comprehensive CGT
- It has existing provision dealing with land sales, of particular relevance s CB6
- Triggered when land acquired with a profit making purpose is sold
- Involves subjective test relating to point of acquisition

Introduction

- IRD have found it difficult to apply because of subjectivity and reference back to acquisition, even though the ultimate onus of proof on the taxpayer
- IRD is aware of considerable speculating in land and non-compliance with s CB6
- While non-residents are taxed on NZ sourced income (ss BD1(4) and (5)), it is practically difficult to enforce even when IRD knows they owe tax

Introduction

- Government response with 4 interrelated measures announced in the Government in Budget 2015 ('taxing property gains fairly', 17 May 2015)
 - Part 1 – Increase in IRD funding to investigate land transactions
 - Part 2 – Land Information and Offshore Persons Information Bill
 - Part 3 - Bright-line Test for Residential Land Bill
 - Part 4 - Residential Land Withholding Tax
- Gather better tax information, esp non-residents
- While affects all purchasers and vendors unless exempt, it is aimed at "offshore persons" the focus of this presentation

IRD Funding

- First response, Minister of Revenue, McClay, announced a further Budget allocation of \$74 m over 5 years (Media release 22 May 2015)
- \$29m in extra funding to increase IRD investigation of property speculation to make sure people pay their “fair share”
- Commissioner had allocated significant resources to reviewing property transactions, so with this injection total funding \$62m
- Establishment of specialist property teams in IRD focusing on review and audit of property transactions
- Expected to generate additional \$420m over 5 years
- Funding will ensure greater compliance with both s CB6 and new “Bright-line” measure s CB6A

Land Information

- Second response: Taxation (Land Information and Offshore Persons Information) Bill 2015
- Ultimately divided into 2 bills (Land Transfer Amendment Bill and Tax Administration Bill) as it amends Land Transfer Act 1952 and Tax Administration Act 1994
- Enacted 22 September 2015, effective from 1 October 2015
- Purpose is to gather more meaningful information re land transactions for tax compliance purposes for both NZ tax and overseas jurisdictions
- Unless exempt, all purchasers & vendors must complete a Land Transfer Tax Statement when settling residential properties from 1 October 2015: ss 156B and 156C Land Transfer Act 1952

Land Information

- Solicitor/conveyancer must sign off on the Land Transfer Tax Statement
- Tax Statement needs to show:
 - Purchasers and vendor's NZ IRD number
 - Offshore persons also have to provide foreign Tax Identification Number
- Offshore persons will need to have NZ bank account before applying for NZ IRD number: s 24BA(1)
- Offshore persons with an existing IRD number must provide IRD their current bank account number: s 24BA(2)
- The key is to force overseas investors to identify themselves
- IRD will have more information for investigation and compliance
- Also part of new measures to address money laundering, particularly overseas money being invested in the NZ real estate market (AMLCFT Act)

Land Information

- Tax Statement submitted to Land Information New Zealand Office who will forward information to IRD: s 81(4)(v)
- IRD may supply the information to overseas tax authorities
- Concern that non-residents not paying tax in NZ nor country of residence
- No new specific provision in the Act
- Existing DTAs and Tax Information Exchange Agreements (TIEAs) authorise exchanges of tax information, discussed later

Land Information

- A new definition of “offshore persons” was introduced into s 3 TAA
- This is distinct from “resident” and “non-resident”
- Extends beyond non-residents
- Include Permanent Resident (ie residence visa but not a citizen) who are absent from NZ >1 year
- Include NZ citizens who are living offshore, who are absent from NZ > 3 years)
- There is an exemption for NZ Individuals (ie not offshore person) selling their main home: s 156A(2)
- Can only claim this exemption twice in a 2 year period
- Offshore persons cannot claim an exemption from Tax Statement: s 156A(1)(b)

Bright-line Test

- Third response, Taxation (Bright-Line Test for Residential Land) Act 2015 to ensure residential investors pay their “fair share of tax” (Minister of Revenue, 29 June 2015)
- Effective from 1 October 2015
- Introducing “bright-line test” to supplement existing “intention to sell” taxing provision in s CB6 by introducing an objective test
- Taxing Profit derived from Residential Land sold within 2 years of acquisition after 1 October 2015: s CB6A
- Acquisition is date registered on Landline
- Disposal is date of the sale and purchase agreement
- Expected to raise additional \$5m per year
- While affects all vendors unless exempt, again the focus is on offshore persons

Bright-line Test

- An exemption again for NZ Individuals (not offshore persons) selling their main home: s CB16A
- Can only claim this exemption twice in a 2 year period
- Effective rollover relief for transfers on inheritance: s FC9(2)
- Effective rollover relief for transfers of relationship property: s FB3A
- Two specific anti-avoidance provisions: ss GB52 and GB52
- As s CB6A confined to residential land (defined in s YA1), could be avoided by selling interest in a land rich intermediary, like a company
- Section GB52: a co. that holds land within the two year 'Bright-line' period and residential land makes up 50% or more of the co. assets and sale of 50% or more of the shares with purpose of defeating s CB6A
- Section GB53: similar provision for trusts
- DTA issues discussed later

Bright-line Test

- Profits will be taxed but losses cannot offset other income
- Losses are ring fenced: s DB18A Can only offset profit from other land sales
- Deductible costs: purchase price; capital improvements; renovation costs; sale commission: s DB18A
- Interest, rates and insurance not deductible against profit
- Only deductible if satisfies nexus test under normal tax rules under s DA1
- May lead to increased compliance under s CB6 as losses not ring fenced under s DB23

Residential Land Withholding Tax

- While non-residents are taxed on NZ sourced income (ssBD1(4) and (5), practically it is difficult to enforce even when IRD knows they owe tax (John Key, 17 May 2015)
- Fourth measure, Residential Land Withholding Tax (RLWT) announced on 31 August 2015 and effective from 1 July 2016
- Only affects offshore persons selling New Zealand property that is subject to the bright-line test
- Calculated lower of
 - 33% of the gain on sale (sale price less acquired price) **OR**
 - 10% of the agreed purchase price
- RLWT is payable at the time of settlement
- RLWT is not a final tax, so offshore persons will need to lodge a tax return

International Tax Issues

- Focus of the measures is on offshore persons gives rise to six issues
- First, IRD may share the information from the Land Transfer Tax Statement with overseas tax authorities
- It will bolster compliance with tax obligations in the off shore person's country of residence
- It is part of a broader program addressing money laundering
- DTAs: Article 26 OECD Model Convention
- TIEAs: NZ has negotiated TIEAs with 20 jurisdictions

International Tax Issues

- Second, non-residents are taxed on New Zealand sourced income under ss BD1(4) and (5),
- Subject to DTAs negotiated between New Zealand and other States
- DTAs are incorporated through s BH1
- Section BH1(4) provides for the overriding effect of DTAs
- DTAs allocate the taxing rights between the contracting Nations through distributive Articles
- New Zealand's DTAs are generally based on the OECD Model Tax Convention on Income and on Capital
- Article 13(1) provides that the gains from the alienation of immoveable property are taxed by the source state
- In the case of the Bright-line measures, under Article 13(1) NZ has the right to tax the capital gain on the sale of land situated in NZ
- Overrides the residual provision, Article 13(5)

International Tax Issues

- Third, interplay between anti-avoidance provisions ss GB 52 and GB 53 (and s CB6A) and Article 13(4)
- Article 13(4) deals with the alienation of shares deriving more than 50% of the value of the shares directly or indirectly from immoveable property situated in the source State
- Article 13(4) provides that it is the source State, not the State of residence, that has the right to tax gains
- Thus ss GB 52 and GB 53 (and s CB6A) comply with Article 13(4) and allow NZ to tax the sale of shares in land rich companies where the land is situated in NZ
- Some DTAs do not include an equivalent to Article 13(4) or have modified Article 13(4) to give the taxing right to the country of residence
- Arguably ss GB52 and CB 6A will be in breach of these DTAs
- FCT v Lamesa Holdings BV

International Tax Issues

- Fourth, interplay between anti-avoidance provisions ss GB 52 and GB 53 (and s CB6A) and Article 13(5)
- If the DTA does not include an equivalent clause to Article 13(4), an equivalent clause to Article 13(5) would apply
- Article 13(5) gives the right to tax the capital gain to the country of residence
- In the case of the sale of shares, even in a land rich company, Article 13(5) would give the right to tax to the state of residence.
- Under this view ss GB 52 and CB 6A would breach these DTAs
- In regard to both Article 13(4) and Article 13(5), better view is that Article 13(1) is the relevant clause that gives that right to the source State
- The effect of ss CB52 and CB53 is to deem a sale of the residential land situated in NZ and taxed under s CB6A

International Tax Issues

- Fifth, some DTAs include a non-discrimination clause modeled on Article 24(1) of OECD Model Convention
- NZ policy is not to include a non-discrimination article in its DTAs
- NZ has a reservation to the OECD Model that was lodged in 1977
- NZ still has agreed to various forms of non-discrimination Articles in approximately half its DTS
- Article 24(1) prohibits discrimination against “Nationals of a Contracting State ... in the same circumstance...” particularly residence
- Reinforces difference between nationals and residents
- Discrimination on basis of residency does not breach Article 24(1): CIR v United Dominions Trust Ltd
- NZ tax rules based on source and residence do not breach Article 24(1)

International Tax Issues

- Article 3(1)(g) defines national as an individual possessing “nationality or citizenship of that contracting state”
- Cannot discriminate on the basis of nationality: *Re Pinacothèque nationale d'Athènes*
- Cannot discriminate on the basis of citizenship
- Definition of offshore person does relate to residence
- But focus is citizenship; different test for New Zealand citizens and non-citizens
- Breaches Article 24(1) and any equivalents in NZ network of treaties

International Tax Issues

- Sixth, some DTAs may not specifically refer to capital gains, particularly as New Zealand does not have a comprehensive capital gains tax
- Article 2(1) recognises that the model DTA applies to taxes on “income and capital”
- The heading to Article 13 makes specific reference to capital gains
- DTAs would at least refer to “gains” or “income”
- The profits that are assessed under s CB6A are statutory income within s CA(1)(a)
- Thus there would be no need for specific reference to capital gains

Conclusion

- IRD was underfunded in terms of its ability to investigate property transactions, esp re land
- The increase in information provided to the IRD through the new measures will assist with investigation and audit of land transaction especially non-residents
- It will bolster compliance (possibly voluntary) with both NZ tax, but also overseas tax obligations
- It is part of a broader program addressing money laundering with 'dirty money' from overseas being pushed into NZ residential land market
- Bright-line test is objective and removes the uncertainty of a subjective test determined at the point of acquisition
- Were the international implications thought through? A deliberate treaty override?