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## **Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Bill**

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*26 January 2016*

### **Introduction**

1. The Property Law Committee (“the Committee”) of the Auckland District Law Society Inc. welcomes the opportunity to make submissions on the Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Bill (“the Bill”). This submission will focus only on the Residential Land Withholding Tax (“RLWT”) aspects of the Bill.
2. The time for consultation on the Bill has been limited in light of the Christmas/New Year holiday period. In the little time available the Committee has considered the Bill and the Commentary Paper and makes the following submissions.

### **Negative Impact on the Development of New Housing**

3. The development of residential housing in New Zealand is not only carried out by New Zealanders but also by offshore persons. Historically, offshore persons have developed property in New Zealand and paid their tax. If the new legislation does not include an exemption for these people of good repute and requires them to pay RLWT on each transaction that comes within the Brightline test these developers will suffer serious cashflow consequences. Cashflow is of course a critical element for any property developer and given the inability to offset costs when the RLWT is paid this new regime will act as a major clog on the development of residential property in New Zealand.
4. Both apartment developments and subdivision sections are often sold “off the plans” well before the title is issued, and for both apartment buildings and bigger subdivisions there can be extensive capital expenditure which does not get taken into account under the brightline test. This may encourage offshore developers to delay going to market and then completing construction to prevent the clog on their capital.

5. The development of housing has been a topic du jour for some time and in effect the government will be scoring an own goal by failing to include an exemption for reputable offshore persons/developers.
6. A solution is at hand and that is the use of a bank bond. Bank bonds have traditionally proven to be an effective technique of avoiding the cash flow dilemma for developers in relation to their dealings with territorial authorities.
7. The bond can be registered on the titles of unsold properties to secure payment of RLWT at a later date and discharged when the RLWT obligation is met.
8. In order to avoid the significant clog the RLWHT will have on property development we submit a bond system is incorporated into the legislation.

### **Costs**

9. The imposition of “paying agent” status (cl44. RL 2 (2)) upon lawyers when acting for an “offshore person” will add significantly to the costs of carrying out a conveyancing transaction.
10. The lawyer will now be required to determine whether the tax is applicable, calculate the correct tax and the pay the tax. The danger of failing to adequately address the issues involved will increase the lawyer’s exposure to risk and thus increase their professional indemnity insurance premiums.
11. These costs will be passed on to the consumer which in turn will negatively impact New Zealand’s reputation as a straightforward and cost effective place to deal with land.

### **Penalties**

12. The IRD have not indicated what penalties the lawyer will incur if they get it wrong in their role as “paying agent”. How will their conduct be assessed and what standard of inquiry is expected from them?
13. Offshore vendor’s will try to do everything possible to avoid paying the RLWT and will place extreme pressure upon the lawyer to determine that the tax is not applicable.
14. The legislation must include precise tests so that a lawyer can decide whether or not the tax is applicable without having to obtain an expert tax opinion. The Bill must clearly set out the mechanics of the process in an effort to minimise any discretion on the lawyer’s part. Without the ability to exercise discretion the lawyer will be able to rebuff the undoubted attempts of the off shore vendor who is seeking to avoid paying the tax.

15. It is critical to lawyers that any penalties imposed are deemed to be “civil” penalties rather than “criminal”. If the penalty is deemed to be “criminal” it is likely to impact on the lawyer’s ability to continue to practise law.

### **Avoidance**

16. The legislation does not deal with the undoubted techniques that will be used to avoid the RLWT. In particular option fees could be used to disguise the purchase price and therefore to reduce the RLWT. Parallel agreements are also likely to be used. A separate chattels agreement which uses an inflated value to consequently deflate the property purchase value could also be used. The legislation needs to specifically address these techniques if it is to retain its integrity.
17. Is there a duty on the lawyer to investigate or to take into account when assessing values any mechanisms in a sale and purchase agreement to reduce the purchase price? Is it explicit that there is no duty for a lawyer to inquire behind certified statements? What if they have either knowledge or a suspicion that a certified statement may be incorrect? The legislation must deal with these issues.

### **Definition of an Offshore Person**

18. For a company (or unit trust) to qualify for the non-offshore exemption, all of the following must be met:
  - a) The company is registered in New Zealand, and
  - b) All directors and executives are non-offshore individuals, and
  - c) No more than 25% of the shareholder decision making rights are held by offshore persons.
19. We submit that these requirements are excessive. There will be some companies which are quite clearly domiciled in New Zealand and are registered New Zealand tax payers that may have an offshore director, it seems to be going too far for these companies to be classified as offshore. A requirement for the majority of directors would be superior to the requirement for all.
20. It is likely to be damaging to New Zealand industry to exclude all overseas based individuals as directors. It is not uncommon for such directors to bring an expertise/experience that is not readily available from within New Zealand.
21. Many companies will have a plethora of shareholders, some of whom may be disengaged with the actions directors are taking and it may be impossible for a lawyer to assess whether 25% or more of the shareholders are offshore persons, which would not be the case in a closely held company. How will a lawyer make a determination in that instance?

22. Could they rely on certifications of directors, or rely on the residential addresses registered at the Companies Office to make that determination, or a combination of the two? There shouldn't be any comeback on the lawyer if they have made their best efforts to ascertain this. The legislation should be clear as to what can be relied on.
23. For a trust, the rules are more complicated and if any of the following apply the trust will be an offshore person:
- a) The trustee is an offshore person
  - b) The trustee has a co-trustee who is an offshore person
  - c) A settlor is an offshore person
  - d) All natural person beneficiaries are offshore persons
  - e) All beneficiaries and all discretionary beneficiaries are offshore persons
  - f) A beneficiary who is an offshore person has received a distribution from the trust within the last six years of a relevant disposition of residential land.
- A corporate trustee will need to meet both the company and trust criteria for the exemption to apply.
24. As for requirement at clause 45 (8)(b)(iv) of the Bill and repeated above at para 23. (e)- Discretionary beneficiaries have no entitlement to trust monies and so their tax status should be irrelevant.
25. Further, the requirement at clause 45 (8)(b)(vi) of the Bill (above at para 23. (f))- – will this apply even if that person is now an offshore beneficiary but was not offshore when the distribution was made? Are lawyers going to have to view 6 years of trust accounts to view distributions made or can they rely on the certifications of trustees?
26. We envisage further problems relating to the tax status of settlors. Many settlors are lawyers or accountants, and may not have powers of appointment or control after a trust has been settled. They may also be impossible to track down in intervening time if they no longer have an involvement with the client.

## **Priorities**

27. The amendment to the legislation (from the original issues paper) is supported as it deals with the practical reality of often only being told of the amount required to repay a mortgage on the day of settlement, and negotiating a different figure with a bank if possible could have clogged the chain of settlements on settlement days.
28. Under the amended legislation the RLWT has priority ahead of mortgage repayment sums. While it is acknowledged an adjustment has been made to allow for a modified repayment sum to be utilised which can cause the RLWT to be reduced

there will need to be a further priority amendment to allow the payment of the real estate agent's commission and the lawyer's legal costs.

29. Without the ability of land agents to be paid for their endeavours in selling a property or lawyers being able to deduct from the sale proceeds their costs in priority to the RLWT neither the land agent or the lawyer will be prepared to act. So that there is no misunderstanding, the legislation will need to be modified to include the ability of real estate agents and lawyers to be paid from the sale proceeds ahead of the RLWT if the new regime is to work.

### **Administration of the Withholding Tax**

30. Here we include several problem scenarios that require addressing before the RLWT comes into effect:
- a) What happens if there are joint vendors and only one vendor is an offshore person?
  - b) What if a property is being sold with one purchase price but includes more than one certificate of title, and some titles do not have houses on them?
  - c) How will a lawyer apportion the value of a purchase price when the land has subsequently been subdivided and sold as separate lots, particularly if one lot has a pre-existing house on the land and the others are bare sections?
31. We request that the IRD answer these questions and provide extensive examples of how other different scenarios should be treated. This will be of great assistance to the "paying agent" and will in turn cut down on queries received on the RLWT enormously.
32. Will there be a dedicated resource within the IRD to provide support to paying agents who are making assessments and require assistance?
33. The provision for the paying agent to pay the RLWT on settlement of the sale or monthly at the option of the agent would be appreciated. As well as written confirmation from the IRD of the amount of RLWT received in relation to the Tax Payer so that this can be provided to offshore clients for offshore tax returns they will need to comply with in their respective tax jurisdictions
34. Paying agents should be able to issue the RLWT certificates for their clients.
35. The requirement to file an interim income tax return. Will this just cover the costs in relation to the actual property or is it the tax payer's wider tax affairs to that date?
36. It would be helpful if certifications required by vendors under this legislation were included in the tax statement so that there is not further paperwork for information a conveyancing agent is relying upon for certification.

37. We submit that an online tax calculator for RLWT will need to be created for the 1 July 2016 commencement date.
38. What is not clear from the definition is whether the RLWT applies only to the GST exclusive amounts. If the amounts are GST inclusive this would lead to inaccurate amounts being deducted.
39. And finally, the actual RLWT in every situation will be more than the actual tax owed, if any. This is because the RLWT calculation does not allow for costs of acquisition, costs of disposal, any improvements, or any existing losses. Or in the case of a resident co-owner they may not be liable for the tax at all. There is no reason why the tax could not be allocated on a percentage of ownership basis. This would save all the extra costs of recovering the refund, not to mention the opportunity cost of the use of the money.
40. The government is essentially receiving a loan from taxpayers for the over taxing, and the taxpayers receive only a small amount of interest (which is subject to tax), in compensation.

Auckland District Law Society Inc. Members will be happy to enter into further discussions with the IRD to fine-tune the operation of the RLWT.

Auckland District Law Society Inc. records that it will want to be heard at the Select Committee hearing.

Bryce Town  
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